

**Noble's Secrets
of
Art Funds and Art Investing**

**The Comprehensive Guide to Art
Funds, Art Trends And Art Markets**

by Dr Greg Nazvanov MBA CFP®

Artbank & Lulu, Inc.

2010

NOBLE'S SECRETS OF ART FUNDS AND ART INVESTING

The Comprehensive Guide to Art Funds, Art Trends and Art Markets

by Dr Greg Nazvanov MBA CFP®

ISBN 978-1-4457-2079-1

Copyright © 2008, 2009, 2010 Dr Greg Nazvanov
All Rights Reserved

Artbank & Lulu, Inc.
3101 Hillsborough Street, Raleigh, NC 27607-5436 USA
Rue du Tunnel 17, CH-1227 Carouge-Genève SUISSE

TABLE OF CONTENTS

Art as a business.....5

Diversification 15

Economics and Art..... 23

Art Investment Funds – a Low Success Rate 27

Conclusion..... 47

Appendix 1. Your Investment Risk Profile 49

Disclaimer 56

References..... 59

ART AS A BUSINESS

Those new to the art market/industry often perceive the process of investment in art funds as deceptively simple: a manager receives capital from buyers, purchases works of art, and then sells them a few years later for a profit.

If it were that easy, there would be a myriad of funds in existence, all achieving double-digit returns. But this is not the case - there are far fewer established major art funds than there have been marketing campaigns for such funds.

Following are an indication of the activities required by managers of an art fund:

- raising initial capital – a significant hurdle for many would-be art funds;
- communicating with investors;
- sourcing possible artwork for acquisitions;
- purchasing artwork – from private sales, commercial galleries, or auctions;
- managing the logistics for acquired artwork (storage, transportation, security, and insurance);
- negotiating the loan of artwork to galleries and museums;
- ensuring compliance with government regulations;
- deciding when to sell particular artwork on the market; and
- selling the art and distributing profits to investors, auction houses and tax agencies.

The idea of art as an investment is hardly a new one. From ancient times, members of the ruling class commissioned works of art to add value to their homes and to augment their personal prestige. The famous artists of the Renaissance – Michelangelo, Caravaggio, da Vinci – had the leisure to create their masterpieces because wealthy families served as their benefactors, paying for their living expenses while they painted, sculpted, and invented.

In modern times, the idea of investing in art may not seem at all similar to investing in a company, or in a managed fund. Indeed, there are financial institutions that had dipped their toes in the pool of art investment funds, only to pull back as the recession of recent years deepened.

There was a time when art was valued because it was aesthetically pleasing and because it brought grand ideas into public discourse. In modern times, art is also gaining value as an investment – not just as a long-term source of goodwill, but as a short-term source of quick profits. Over the past ten years, the art market has shown volatility similar to that of the stock market, and yet some of the prices that works of art have yielded at market have made it an attractive investment asset class. Indeed, the art industry has a worth in excess of \$3 trillion with an annual purchasing and selling of over \$30 billion – and the returns are often just as lucrative as those in the stock market, if not more so¹. Andrew Worthington and Helen Higgs have pointed out that investing in art means entering a market with an increasing demand but a limited supply². Despite some recent success, an art investment operates differently to other more traditional investments. For example, instead of earning a dividend, it aims to achieve a capital gain. Art also doesn't appreciate or depreciate in a regular pattern with like assets, as happens with real estate. Rather, each piece may have its very own patterns for growth and loss. Further, investing in art is placing your funds on the future value of something that cannot be logically valued or priced (at least not in basic financial terms). Finally, there are specific overhead costs associated with

art, like insurance, transportation, storage, expert valuations, cataloguing or exhibiting, that are not associated with other types of investments.

The supply issue seems to be changing. Contemporary Indian and Chinese art is growing in popularity- the supply in these areas is not as limited as it is in other segments of the art market, and prices are increasing. Given the current thaw in the global economy, now may well be a prudent time to enter the art investment market. One must bear in mind, however, that this current upswing represents part of an ongoing cycle, and that similar cycles plague the entire spectrum of investment opportunities.

Classical sculptures, vases, coins, drawings, paintings, and antique furniture have been traded for centuries. Even though art can be seen as a commodity, just like other valued items traded through financial markets, there have been very few art funds that have achieved major success, and the history of art funds is quite limited. Art is yet to be seen as a commodity that rewards investors.

A major reason keeping art from becoming a commodity is social status. One characterisation of the social elite has long been the ability to invest large sums of money in objects for the sole purpose of collecting and enjoying them, rather than trading in them. Despite this characterisation, for some the idea of trading art conjures images of the painting mill, for example, the mass-produced photographs and prints sold by large retailers.

In the 1800's, the ability of the stock market to provide wealth to its investors made art seem more like a collecting passion rather than a commercial endeavour and art lagged behind other sorts of trade opportunities.

As early as the 1850's, academic enthusiasts suggested the possibility of a fund designed to invest in fine art, and formed clubs to buy and sell selected works from emerging artists.

One example of such a club was the *La Peau de l'Ours* syndicate, which supported new artists and rewarded member artists after the recognition of Impressionism as one of the major milestones of French culture.

As other areas of the economy modernized, so did the art markets. The British Rail Pension Fund was one of the earliest to invest heavily in artworks from 1974 to 1989. Investors gradually became more used to the idea of a wide range of investment opportunities and the need to diversify investments in an attempt to reduce risk.

Nowadays, the perception of investment in art has shifted to the extent that it is seen as far more 'trendy' and visionary than investing traditional investments.

Any investment involves varying degrees of risk. Firstly, there are general investment risks, common to all investments, which include factors such as inflation, interest rates movements, government legislation, taxation and changes in consumer confidence.

Secondly, there are art specific risks. These are risks with particular relevance to the art market, like:

- market risk – the potential for the art market to move in an unfavourable direction or show signs of volatility, so that investors begin to lose confidence;
- time-frame – art is a medium to long-term investment; your money may be tied up for several years;
- liquidity risk – art investment is typically an illiquid investment, and artworks cannot be bought and sold instantly on impulse;
- valuation risk – the value of a work of art is a matter of opinion, and this value may not be realised when the artwork is sold;
- insurance risk – insurance may not cover all events of loss;
- works of art may be damaged or destroyed; or
- there is the risk of buying a fraudulent copy of a painting.

Art investment funds and art trusts bring with them a further set of risks, including:

- lack of past performance – the investment fund may have no experience in investing in art;
- risk in selecting assets – the potential for artworks depreciate in value;
- operational risk – business processes and procedures must be sufficient to record and safeguard the assets. Further, when the artworks are not held by the custodian, (for example, when they are loaned to galleries or museums), an audit trail may not be properly maintained;
- tax – there is always the risk that tax laws may change in the future and impact on the investor’s distributions. As with any investment, investors should talk to their own tax adviser before making any decision;
- compliance risk – if a trust or a fund does something to jeopardise its financial services licence issued by a regulator, this could affect investment and the fund’s sustainability as a financial entity; and
- liquidity risk – because of the market, you may not be able to sell your investment when you want to, or at all. The secondary market for art is unregulated and fragmented;

Lastly, there are economic, political and social risks. An economic downturn can affect investments, and may affect the ability of an art trust or art fund to buy or sell art. It is hard to anticipate changes in government policy or predict social instability and these pose significant risks for investors.

Managers are compensated by investors for their expert ability to pick a strongly performing artwork portfolio, which includes an assessment of the associated investment risks, as described above. Many funds want managers to invest in their funds themselves, as a sign of credibility, thus having a personal stake in the profit of the fund rather than just collecting a fixed management fee regardless of the fund’s performance.

<p>Art investing</p> <p>Benefits</p> <ul style="list-style-type: none"> ▪ Focus on Art Expertise ▪ Insider knowledge, data ▪ Low transaction costs ▪ Multi-tier due diligence process ▪ Active asset management ▪ Co-investment and art syndicate services ▪ Art adds diversification benefits to a portfolio <p>Drawbacks</p> <ul style="list-style-type: none"> ▪ Lack of personal involvement ▪ Fixed exit strategies 	<p>Vs.</p>	<p>Private collecting</p> <p>Benefits</p> <ul style="list-style-type: none"> ▪ Enjoyment of collecting ▪ Personal management and exit strategies ▪ Art adds diversification benefits to a portfolio <p>Draw backs</p> <ul style="list-style-type: none"> ▪ High transaction costs ▪ Lack of insider's knowledge ▪ Volatility higher in risk vs. Return ▪ Lack of expertise
--	-------------------	--

Art Investing versus Art Collecting

Investors contribute capital into the fund, with research suggesting a typical single contribution to be around US\$250,000³. The aim is to pool funds to invest in particularly well-known works or in a more diverse art portfolio. This investor contribution is typically locked into the fund for five to ten years. Investment in such funds is not made through a public prospectus, unless the fund applies for an exchange listing. A key difficulty faced by art investment fund promoters is that very few investors embrace the notion of art funds on a sufficient commercial scale, This could be for reasons previously described – motivation for purchasing a piece of art is usually non-financial and a highly individual/subjective decision. Regardless of these reasons, those that do invest in art commercially will want to gain or hedge art market exposure and participate in its development.

Art market sales are continuing to perform better than expected, even in today's depressed financial climate – with the fall out of the global financial crisis and the sub-prime crisis. Recently, several economists have come out in favour of art, including

Mei and Moses (2002)⁴, Eckstein (2006)⁵, Frey (2003)⁶, Deitch (1989)⁷ and Campbell (2005)⁸. They consider art investment a good way to diversify a portfolio, because it does not fall into the same category as more traditional assets such as stocks, equity, bonds and cash. It was this perspective that led to the modern day art investment fund resurfacing in 2001, based on the idea that there was “speculative money to be made from the art market”.⁹

This is supported by the graph at Figure 1 which illustrates the favourable performance to date of art, in comparison to other alternative assets .

Investment in art follows usual economic patterns. Art is in high demand because by its nature, artworks are unique and in limited supply. This is further compounded as most of the world’s great works of art are only to be found in art galleries or private collections. Economically speaking, this creates a collection of “goods” that are not readily converted into cash, and unpredictable. In present economic times, investors are finding that art is working well as a protective asset.

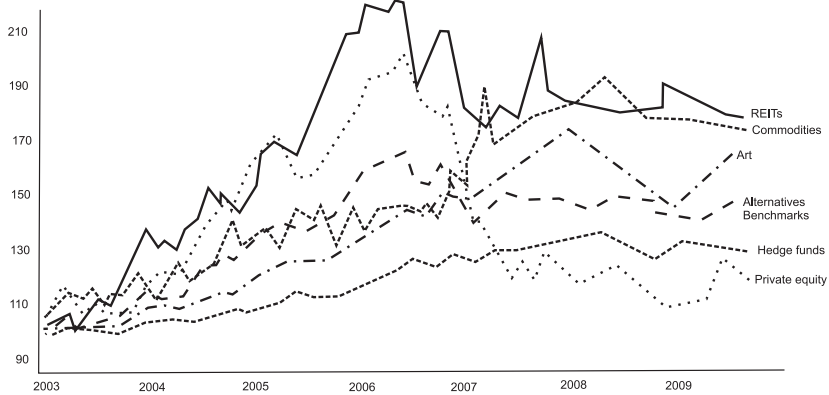


Figure 1. Performance of Alternative Investments¹⁰

Table 1. Mei and Moses Study (2005) Compound Annual Returns and Correlation Data for Art, S&P 500, UST 10 yr, UST Bills and Gold for the Last Fifty Years.

	MEI MOSES	S&P500	UST10 YEAR	UST BILLS	GOLD
	ALL ART	TOTAL RETURN	TOTAL RETURN	TOTAL RETURN	TOTAL RETURN
Last 50 years	10.47%	10.95%	6.64%	5.42%	5.17%
Last 25 years	7.97%	13.51%	9.81%	6.13%	-1.11%
Last 5 years	7.27%	-2.40%	7.47%	2.63%	8.79%
Last year	13.00%	10.88%	5.06%	1.31%	5.60%
ALL ART CORRELATION	1.00	0.05	-0.19	0.06	0.11

As previously mentioned, the first art investment fund - *La Peau de l'Ours* was set up in France in the early twentieth-century by financier André Lev. He did this by pooling money with 12 other investors to buy more than 100 modern artworks, paintings and drawings. This collection included pieces by Picasso, Matisse and Van Gogh. When these works were sold at auction 10 years later, in 1914, their value had appreciated considerably over the decade, and investors received a four-fold return on their original investment. More art investment funds emerged for a short time in the 1970s. One of these was the legendary British Rail Pension Fund which gave investors returns of approximately 11.3 percent. The fund had purchased an eclectic range of artworks including medieval art, Chinese ceramics, Old Masters, Impressionists and African tribal art, as well as rare and valuable books and manuscripts. The entire collection was auctioned between 1987 and 1999, resulting in good profits for its investors. However, the fund was shut down by the Inland Revenue Service, which ruled that a pension fund should not be involved in the art business.¹¹

It was not until 30 years later that the art investment boom really began to take hold, with no fewer than 50 funds aiming to establish

in 2001.¹² One of the instigators was Charles Saatchi, a well-known UK art collector and advertising tycoon. He was interested in the idea that there was “speculative money to be made from the art market”.¹³ The time was right for this speculation. A growing number of high net worth individuals (believed to be worth more than \$30 trillion at current estimates and increasing at 7 percent a year) created a high demand in the art investment market, with analysts estimating such contributions to be approximately \$300 billion.¹⁴

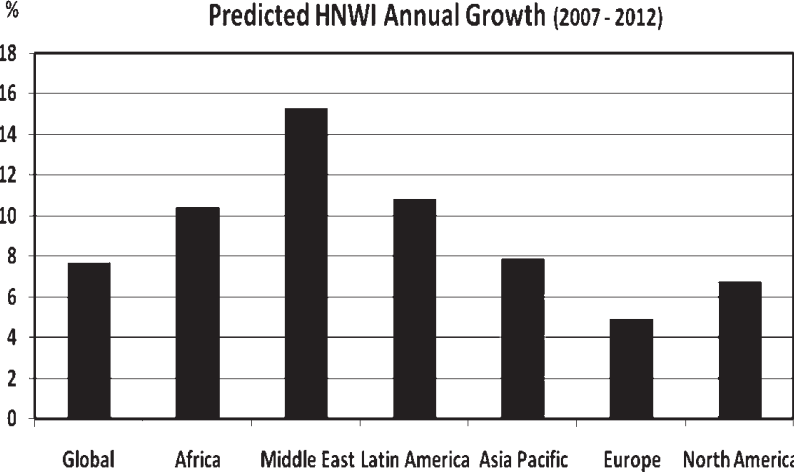


Figure 2. Predicted High Net Worth Individual Growth (2007-2012)¹⁵

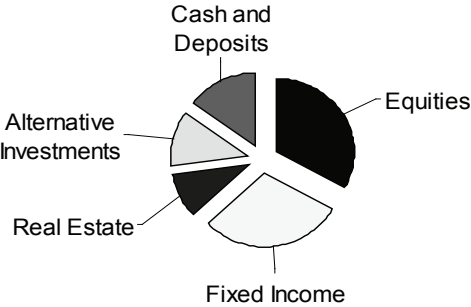


Figure 3. HNWI Asset Allocation of Financial Assets¹⁶

Figures 2 and 3 illustrate the predicted growth of the number of high net worth individuals over the next few years, by region. These increasing numbers, along with the significant percentage of alternative assets that they hold, support the expected expansion of the art market in the near future.

This inclusion of art in a balanced portfolio has important relevance for most Pension Funds and the Australian superannuation market in particular. The following illustrations make a very strong and exciting case for the potential of art investment in Australia and globally. A representation of a diverse, balanced portfolio is shown at Figure 4.

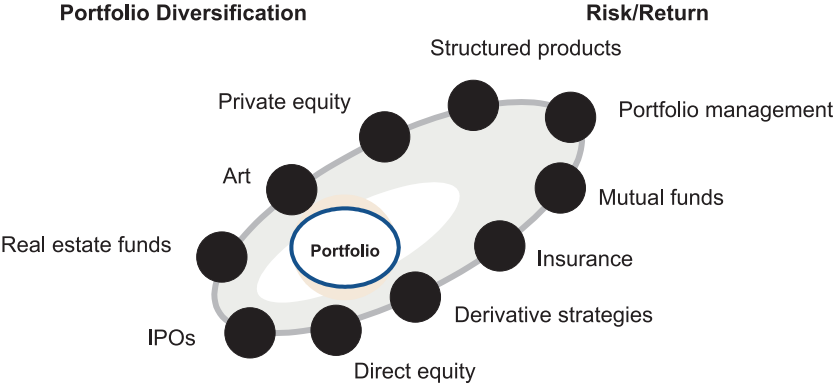


Figure 4. Diverse Portfolio

DIVERSIFICATION

Art as an asset class was found to have less volatility and much lower correlation with other assets as found, hence a portfolio of artworks may play a somewhat more important role in portfolio diversification. While the idea – “don’t put all your eggs in one basket” is timeless, the funds management principles date back to the early 1950’s. In June of 1952, a 25-year-old graduate student published a provocative article in the *Journal of Finance* that would have a profound impact on Modern Portfolio Theory. In his writings, Markowitz discussed risk management through diversification¹⁷. He found that by investing your money across a number of asset classes, there were opportunities to get more return from a given level of risk, or lower the risk of your portfolio without compromising returns.

Modern portfolio theory (MPT) is a theory of investment which tries to maximize return and minimize risk by carefully choosing different assets. MPT is a mathematical formulation of the concept of diversification in investing, with the aim of selecting a collection of investment assets that has collectively lower risk than any individual asset.

Bill Sharpe took Markowitz’ work and developed the Capital Asset Pricing Model (“CAPM”), and introducing Beta as a measure of market risk¹⁸. Markowitz and Sharpe shared the Nobel Prize in Economic Science in 1990 for their work on Modern Portfolio Theory. Building upon the work of Markowitz and others, Gary

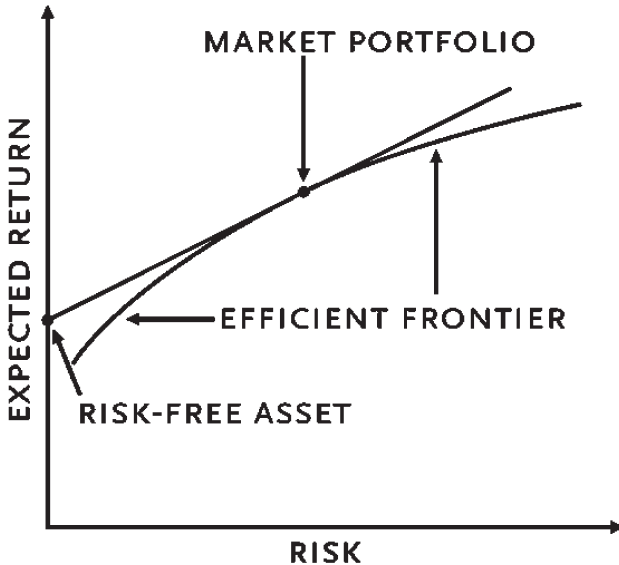


Figure 5. Modern Portfolio Theory

Brinson sought to study the impact of the asset allocation policy decision. The Brinson Beebower studies, originally completed in 1986 and revisited in 1991, suggested that 93.6% of a portfolio's change in returns over time were attributable to asset allocation policy¹⁹.

Different types of investments perform better under different market conditions. By investing in more than one type of investment you diversify, which can help reduce the risk for your overall investment portfolio. The more ways you diversify the more likely you are to reduce your risk.

When it comes to the question where to put your money, there are five major asset classes where you can invest in that will earn some type or return: Cash, Fixed Interest, Property and Shares, or Alternative Assets, e.g. Art (see Figure 6).

Each of these classes has a growth rate and a mix of risk factors that make them attractive to invest in for different reasons. Some asset classes are low risk but you don't make as much money from your

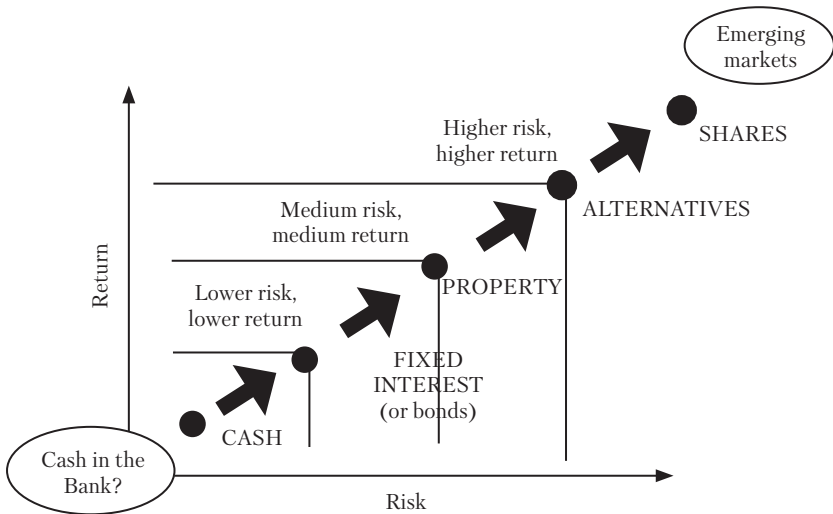


Figure 6. Asset Classes and Risk/Return

investment into them. With others, you have the potential to make a lot of money but the potential to **lose** a lot of money is high as well. Let's take a look at the pros and cons of these asset classes:

Cash (often referred to as Money Market) is the most secure and low risk of the four major asset classes. The types of opportunities found in this class are things like bank savings accounts and interest bearing checking accounts.

Unfortunately, cash assets offer the lowest return on your investment dollars and the least amount of protection against inflation. However, it is still a prudent class to invest in when you don't have a lot of time to invest or you want a stable and fairly predictable return.

Another benefit to having money invested in Cash assets is that it is the most liquid of all the asset classes. Generally, you will have quick and easy access to your money with little to no penalties should you need it in a hurry.

Fixed Interest assets include bonds and debt securities. Bonds and debt securities are basically promissory notes issued by

governments, banks and corporations that investors can purchase at a deep discount.

For instance, the government has a stack of notes valued at \$100 each. They will sell these notes to investors at \$80 a piece with the promise to pay the full value of the note at a later date (usually around 3-10 years, depending on the type of note it is). The note, or bond, accrues interest which is applied to the bond at regular intervals until it reaches maturity (the date the government says it will pay the note). The investor can then cash in their bond for its full face value.

The return on investment for bonds is better than cash but you still won't make as much money as if you were to invest that same \$100 into Property Trusts or Shares/Equity.

The price of Fixed Interest assets is heavily influenced by interest rates. Higher interest rates mean lower bond prices while lower interest rates equal higher bond prices. However, while Fixed Assets are mildly volatile in the market, they are still significantly safer than Property Trusts or Shares and can safely be incorporated into any investment portfolio. Additionally, you can still gain access to your money by cashing in the notes early but often you will only receive the interest you have earned to date and some notes even impose penalty fees for early redemption.

Property Trusts (also known as LPTs, Property Securities or REITs) use the power of collaboration to bring big rewards. This asset class allows investors with a small amount of money to invest to combine their money together and invest into large, managed, real estate assets. This means that you can pool your \$1000 with other investors who only have \$1000 to invest and buy into potentially lucrative real estate assets.

With a Property Trust, you earn money from the property whenever it increases in value. Additionally, the majority of the time, these properties will have tenants renting in them so you also earn money from that rental income.

But, as we have recently seen, property values can fall significantly which puts this asset class into the medium to high risk category. Most of these Property Trusts are traded on the stock market, and thus they can be influenced by the share market short term. For the most part, though, their pricing is a reflection of property values over the long term.

Shares (also known as Equities or Stocks) are basically units of ownership in various companies. Out of all the asset classes, Shares offer the most aggressive opportunity to make money with your investment.

You earn money with your Shares in two ways. First, you receive income via Dividends which are your cut of the profits. How much you get is equal to the number of Shares you hold. So the more shares you have, the more income you receive.

The second way you make money is from the rise in the price of the Shares themselves. For example, if an investor purchases a Share at \$10 and the price of that Share goes up to \$15, then their earning is \$5 if they choose to sell their Shares at that \$15 price tag. How successful a company is and the overall value of their assets determines how much their stocks are worth.

Shares have shown to have a high return on investment over the long term, higher than the other asset classes, but equally, they are subject to huge fluctuations in prices. So while there is a potential for you to make great monetary gains, there is also a high risk that you will lose a lot of money at least in the medium term.

Alternative Assets are assets that are generally not influenced by the other asset classes. It is good to use some of the assets in this class to diversify your investment portfolio because their patterns of return differ from the returns of the other four classes. This translates into stable earnings for you irrespective of economic and investment market cycles.

For example, people are always going to pay their utility bills so an investment in essential services such as water and power will

generally provide a stable and steady return no matter if the economy is down or up.

Some Alternative Assets include Art (e.g. Aboriginal Art, which you can learn more about in my book, Investing in Australian Aboriginal Art), Private Equity (investments made in companies not on the stock exchange) and Infrastructure (investments made in transportation, water and other essential services), Commodities, Currencies and Hedge Funds.

The risk factor of a particular asset class is a component that must be taken into consideration when deciding on where to invest your money. Some asset classes are safer to invest in but offer low returns while others offer big rewards for investing in them but the risk of losing money is high as well. Where an asset class falls on this Risk/Return scale determines if they are either Defensive Assets or Growth Assets:

For example, you could diversify across:

Different asset classes (cash, fixed interest, property, shares, art, private equity)

More than one investment in each asset class (eg several different industries and companies when investing in shares, or combining blue-chip artists with mid-career and speculative emerging art talents)

More than one type of art medium or art style when investing in art, just like you'd use more than one type of fund and investment manager when investing in managed funds.

Let's say you had all your money in just one investment and that investment didn't perform - you would make a loss. But, if you spread your money across different types of investments you may have a better chance of including some investments that will perform.

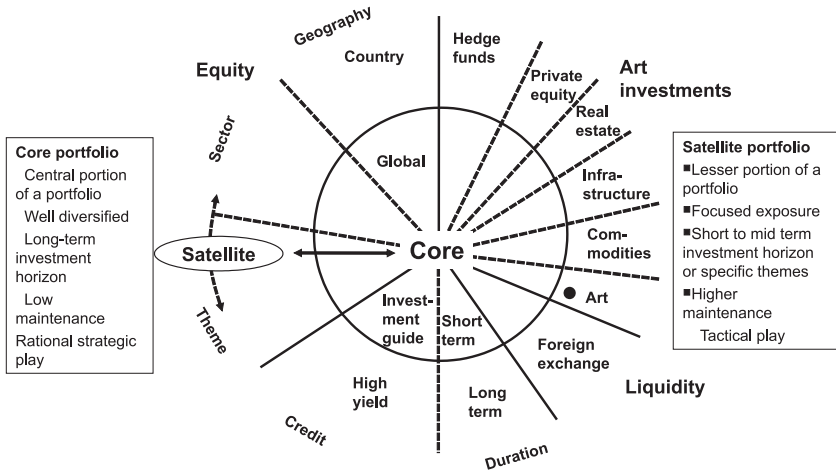


Figure 7. The Core Satellite Approach

If you are thinking about putting together an art investment portfolio, here are some ideas to keep in mind:

- Develop your goals for the portfolio. What is it you want to gain by creating the art portfolio?
- Evaluate your level of comfort when it comes to risk. Some people are by nature risk takers while others tend to be more conservative. There are art investment options that will complement both extremes as well as any mix in between.
- Learn about the many types of art investments. You may consider such items as art funds, investing in shares of art auction houses or art investment vehicles, buy a portfolio of artworks, or start with a single art piece and grow your art portfolio over time.
- Set limits on how much you can invest in art and your overall investment portfolio. Investing should be done with net income that is not earmarked for food, clothing, rent or mortgage, travel and other common budget items. Check your pay slip for any deductions (except tax) already made,

for example superannuation, health insurance, company car. For the most accurate picture, add these amounts back on to your income and then include them in your expenses. Leave out any irregular income that you would not usually receive, for example overtime that is not regular or bonuses for unusually good performance. Look at what you have left over after taking care of your other financial commitments and only use that for your investing activity. Get professional advice. Especially for newcomers, you need the counsel of someone with experience in the financial world.

- Diversify your art investments. You may want to go with a couple of mid-career artists, toss in a speculative emerging talent or two, and perhaps put your money into blue-chip artworks. By diversifying your art holdings, you help to create a situation where one investment may help to offset a temporary loss you may experience with another investment.

ECONOMICS AND ART

Art as a commodity shows characteristics that distinguish it from other alternative assets. First of all, each artist is unique; more importantly, each dealer is different, and artist's access to the marketplace is controlled by and large by dealers' tastes. Dealers also face difficulties of their own: fixed costs are high, including overheads, distribution, marketing, and insurance – not to mention the process of finding and signing the artists themselves.

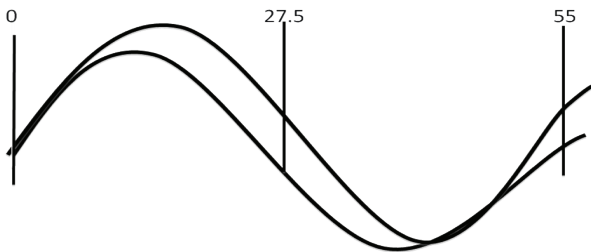
In relation to supply and demand, art works can be likened to fur coats or Lamborghinis - limited supply automatically raises the value. The originality and exclusivity of a piece of art, be it a painting, sculpture or print further enhances the value, although there are four factors to be mindful of in art values over time: changes in income for investors, changes in taste, availability and pricing of works, and the danger of duplication (or substitution).

When it comes to specific pricing strategies, Schweizer (2008) points out that there is a wide variety, depending on the artist's particular niche²⁰. High prices tend to lead to high profits and high-profit artists provide a smaller supply, just like there are fewer Lamborghinis than Toyota Corollas. On the other end of the market, there is the art-fair crowd that depends on selling larger quantities of prints, copies, or other works to make a profit, as their margin per unit is lower.

Pricing strategies for art can be quite complex, accounting for the expected factors of supply and demand as well as more industry specific factors unique to this industry including consumer taste and differentiation. There are generally two types of costs in the art pricing equation: production costs and selling costs (Jyrämä, 1999)²¹. The addition of production costs to the perceived aesthetic value of a piece could feasibly result in the actual price. Selling costs refer to the process of taking a new artist and helping to market them and distribute their work.

To be more specific, there are four elements to the perceived aesthetic value of a work of art: the artist, the work itself, the market, and the macroeconomic situation²². As far as the artist goes, their fame, reputation and the value of previously sold artworks are key to the pricing process. When it comes to the work itself, such factors as the size, technique, medium, content, quality, and certification of authenticity all come into play. Market factors obviously include supply and demand, as well as the authenticity and reputation of the artist. This is where investors must rely on the experts, who are expected to make correct purchasing decisions. The macroeconomic situation includes, as it would when considering investments in any market, the current state of financial markets.

Kondratieff Wave Cycle



Average 55 years (27.5 a piece) and ranging from 18 to 33 years in length

Figure 8. Kondratieff Wave Cycle

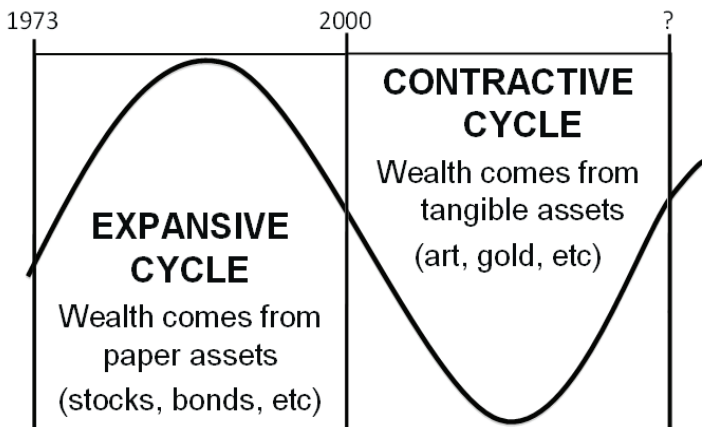


Figure 9. Kondratieff Economic Cycle

The Kondratieff waves (Figures 8 and 9) describe cycles in the modern world economy and are a useful representation of long term business growth and contraction. This cycle is also indicative of the relationship between traditional stock markets and the alternative (art) investment market, supporting art as a valuable portfolio diversification asset²³.

It is true that no economic market is perfectly predictable. If this were true, there would be no risk to investment (and hence only minimal rewards). However, flaws in a market can lead to competitive advantages if a fund/asset manager has the right information. Some of the truths that have become apparent about art again come in to play: the works themselves are unique – they cannot be substituted other than through low-end reproduced prints, assembly-line painting or other crafting. An important factor to consider for fund and asset managers is the notion that art has many subjective benefits for its owners, as Abdini (2007) points out, demand for art often “is not only due to fashion, and it being in vogue, but to the concept of showing off to your neighbor your new found wealth”. As such, the notions of trend, mood, and significance play a major role²⁴ in the decision to purchase art. Can art then, really serve as an alternative investment? Absolutely.

The art investment funds that led the market from 2001, were largely set up by independent investment firms, private entities and individuals, with capital raised used to purchase a variety of artwork to ensure a diverse portfolio. They choose from centuries of artworks including the Old Masters, the Impressionists and Contemporary and Modern Art. Investors are usually locked in to the investment for the life of the fund, which are closed-ended and range from three to 10 years.

News of funds' profitability is usually kept confidential, with evidence to hand suggesting that few funds are making a profit.

ART INVESTMENT FUNDS – A LOW SUCCESS RATE

There are six main reasons for the high failure rate of art investment funds comprising six inefficiencies not found in the more traditional investment market.²⁵

The first issue is the low volume of transactions. In the equity market, financial transactions happen every day; by contrast, in the art market, half of transactions only happen at auctions on set days, often at six monthly intervals.

Secondly, there is no central, reliable information source for buyers and sellers. The emerging numbers of information intermediaries is increasing the amount of available information, but there is still a lack of data regarding the investment performance of art.

The third problem can be summarised as the “museum factor”. Museums and art galleries have strong constraints on the paintings they can sell. This means that some artworks do not come back onto the market.

The fourth difference is liquidity - artworks are traded less often than stocks and bonds.

Next, the art market does not come with standard prices and transparency. The price of paintings, for example, is much more

intangible than that of stocks and bonds. The art market does not have one common, agreed method of valuation - pricing can vary because of many factors, such as networks between dealers and clients, current fashion and just plain luck. The market is also largely unregulated, although recently, the Securities and Exchange Board of India has stated that art funds should be regulated because they deal with public money.²⁶

The sixth and final issue contributing to the high failure rate of art investment funds is that art sales attract very high transaction costs. These costs include purchase tax, insurance, handling, legal and agent fees, which are often more than 5 percent of the purchase price.

The first art hedge fund was launched in June 2007, as a Guernsey-listed closed-end company. Called the Art Trading Fund, it was the first art investment fund to offer a hedge, and commenced at a time when hedge fund focus in alternative investments not linked to stock or bond markets was strong²⁷. Despite the success of early capital raising and strong investor interest in 'exotic' investments, The Art Trading Fund failed, citing onerous ongoing costs and continued poor sales as the reasons for closure²⁸. The firm backing the fund, Artistic Investment Advisers (AIA), announced in December 2009 that the fund would be liquidated that month²⁹.

The fund was established by Chris Carlson and Justin Williams of AIA, a money management company based in the UK, and was similar to a traditional art investment fund, adding derivatives. The fund traded exposure in companies with a strong affiliation with the art market, e.g. Sotheby's or a Swiss company Richemont, which specialises in luxury goods. The fund's portfolio mix was back-tested and suggested a close correlation (96%) with the art market during the past 30 years. This strategy was set up to ensure that if the market fell, the value of these securities would also fall, and the fund would make a profit; derivatives were intended to act as a hedge against market falls³⁰. Designed to protect members' capital, the Art Trading Fund

was set up as a Protected Cell Company – divided into separate sections known as ‘cells’, so that each member’s funds were segregated from that of other members, with individual holdings in the company’s overall share funds. Charles Saatchi, advised the fund on its purchases of contemporary art, and in return received a share of the profit³¹.

The fund was set up to deliver an annual return of 30 percent over a three year closed-end period.³² When it was setting up, the fund stated that these returns would come from an increase in mid-market art purchases and quick trading, which would make it a safer investment than a traditional art fund.

Former corporate trader and now New York art dealer Ashel Edelman argued that The Art Trading Fund was not a real hedge, but only the first step in creating a hedge for art. He stated that it was important to develop derivatives with an art basis to create a true hedge for art. Speaking in *The New York Sun* in 2007, Edelman said that stocks in companies such as Sotheby’s were not perfectly correlated with the art market, that is, Sotheby’s stock may fall for reasons other than art market decline, such as a drop in the stock market³³. Impacted by the GFC, the Art Trading Fund folded³⁴ and a meeting of AIA creditors took place at the offices of the fund liquidator, Wilkins Kennedy, in January 2010.

The recent history of Art Funds has seen both failure and success, an indication of the volatility of both the art market and investor sentiment. What follows is a brief journey through this history, including an overview of art fund operation, a review of some of the current participants, as well as consideration of the evolution in art market operation.

Starting with the basics of art fund operation. At the outset, an art fund establishes their investment policy; such policy typically aiming to obtain a return through the price appreciation of a portfolio of diverse artworks (for example, paintings, decorative art, sculptures and other collectables). Whilst appropriate

artworks are being sourced, funds may be invested in an interest bearing account or short-term instruments to provide returns for investors. Additional revenue may be earned by selling and renting items or purchasing and leasing corporate/private collections.

The fund will also establish its investment guidelines at the start, for example, it may only invest in Australian items in specific mediums, may set a maximum amount to be invested in a specific genre, specify certain items to be purchased and set financial caps for single artworks. These guidelines are regularly reviewed.

Fund managers aim to add value through active management of the art portfolio, with staff expected to identify market opportunities and emerging trends in a timely manner. Figure 10 illustrates a typical fund structure.

Art funds are similar in operation to hedge funds and private equity funds, established to provide income for fund managers and investors alike. It is important to remember, that at the end of the day, funds exist to make a profit, regardless of what they trade in, and as with art funds, despite the highly subjective nature of the investments themselves. An art fund's aim is simply to maximize the rate of return on investment, not to build a permanent collection of art.

Opinion on the predictability of traditional investment market returns is mixed. An efficient market implies that all the information forms part of the price and that price movements are random (Fama 1970)³⁵, meaning that today's price is the best way to predict tomorrow's price. For stock returns based in the US, Timmermann and Granger³⁶ (2004) and Goyal and Welch³⁷ (2002) support the idea that the returns on investment cannot be forecast. Further authors, Campbell and Shiller³⁸ (2001), Claus and Thomas³⁹ (2001), Cochrane⁴⁰ (2006) and Cremers (2002)⁴¹ assert that long-run returns can be forecast for stocks and other asset classes.

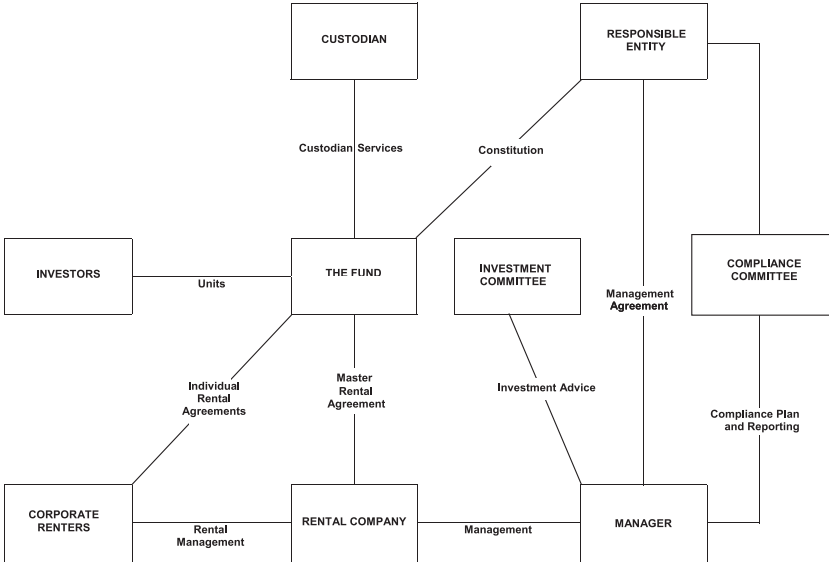


Figure 10. Sample fund structure

It seems to be quite the opposite case for art, with Chanel, Gerard-Varet and Ginsburgh (1996) believing the art market to be ruled by personal taste – thereby possible to predict short-term but not long-term investment results⁴². Whilst stock returns are ruled by basic laws and the rate of return becomes more predictable the longer the investment, taste is a matter of opinion, and prices so influenced are hard to substantiate⁴³ (Daniel and Titman, 2000).

Art funds face challenges like any other investment fund due to changing global economic environments, as well industry-specific struggles. There is the inability to attract new capital into the fund, difficulty sourcing artworks at sufficiently low prices, the potential for excessive outlay where items are overpriced at auctions, and most significantly, there is the substantial expenditure on salaries and management fees.

It was the Netherlands-based banking giant ABN Amro that made early moves to establish in-house fine art funds, aimed at

institutional and wealthy individual investors. Other institutions to follow suit included Citigroup Private Banking in 1979 with its Art Advisory Service; Deutsche Bank, UBS and the major auction houses, such as Christie's and Sotheby's.

Unfortunately, most proposals expired. High profile antiquarian map and book dealer Graham Arader for example apparently failed to secure US\$200 million for a fund specialising in US paintings, allegedly blaming unsophisticated investor attitudes and the poor reputation of art dealers. Market disquiet was reinforced by the very public downfall of New York-based Fernwood Art Investments, founded by Bruce Taub. He had been promoted as:

- the first independent investment adviser to develop a full array of art-focused investment research, advice, financial products, and, services for sophisticated investors and collectors, and
- establishing the first company to provide investors with art-focused investment opportunities.

Fernwood aimed to raise US\$150 million (although apparently only achieved US\$8 million) despite sponsoring high-profile art events such as Art Basil Miami and the Brooklyn Museum's Basquiat exhibition. Although it was claimed that Fernwood would revolutionise art through a "forward-looking predictive tool", the specialists left the building in 2005 before the fund took off. Fernwood's promoter Bruce Taub was sued by Roy Disney for US\$1 million in 2006 and other individual investors in 2007, who believed that Fernwood was nothing but a vehicle for Taub to use the funds of other's to join the world of the art-elite.

Another disappointing performer was India's first art fund, Contemporary 1, launched by Osian's Connoisseurs of Art Pvt. Ltd in July 2006 - a closed-ended scheme with a lock-in period of 36 months. It made a promising start, promoting returns of 35-

Cumulative Australian Art Sales Trends 1988-2010

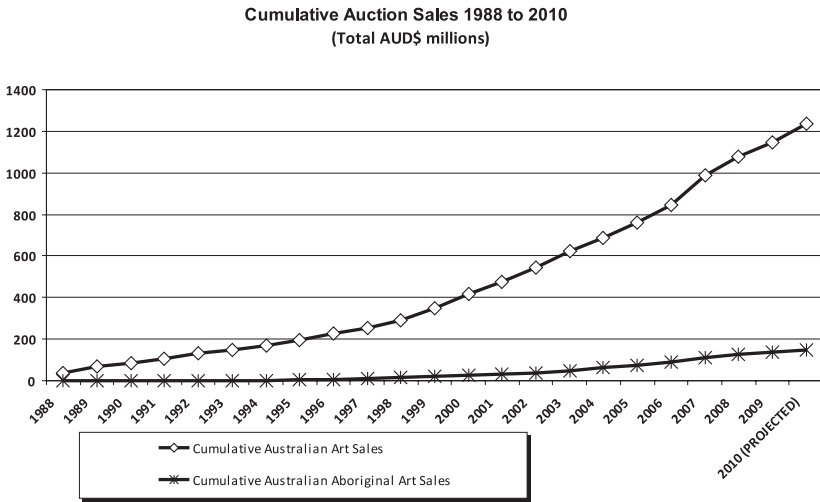


Figure 11. Cumulative Australian Art Sale Trends 1988 – 2010

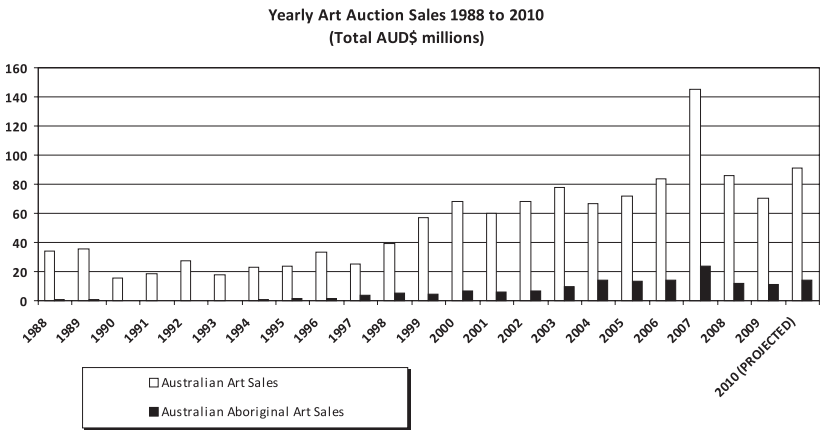


Figure 12. Australian Art Sales Annually 1988-2010

40%, and was launched at a time when such funds were popular with investors due to Indian artists making waves at global auctions. However, the credit crunch swept through in 2008 and prices collapsed. The chairman and chief adviser to the fund claimed this downturn in the art market made it very difficult to sell the artwork, especially as the fund had entered at the top of the market in 2006 and were forced to exit at the bottom of the market. Whilst extraordinary market conditions appear to be the main reason for the fund's failure, market observers also point to both the liquidity risk of art⁴⁴ and the shortness of this fund's lock-in as mitigating factors⁴⁵.

Finally, The Art Fund, an Australian-based trust, was poised to launch in February 2008. Managed by Huntley Management as an investment and rental fund, it aimed to seek a return for investors through the price appreciation of a diversified Australian portfolio. The Trust was intended to operate for five to eight years, and was seeking to raise \$30-50 million, with a \$25,000 minimum investment.⁴⁶

When considering the strong and steady growth in Australian art sales just prior to the launch, The Art Fund was an eye-catching investment proposition at the time, in terms of potential financial returns. See Figures 11 and 12 and Table 2.

Table 2. AMI (Australian Art Market Index) versus Other Asset Classes⁴⁷

1898-2007	109 years average	Australian Equities 7.48% p.a.
1898-2007	109 years average	Australian Equities 12.42% with dividends
1973-2003	30 years average	Australian Equities 7%
1978-2006	28 years average	Australian Equities up 10.1% p.a.
1971-2009	38 year average	Australian Equities 4.68%p.a.
1971-2009	38 year average	International Equities 11.76% p.a.
1971-2009	38 year average	Property Infrastructure 13.35%p.a.
1971-2009	38 year average	Fixed Interest 10.40% p.a.
1971-2009	38 year average	Cash 8.76% p.a.

1973-2003	30 year average	Australian Art up 8.23%
1975-1995	20 year average	Australian Art up 10.3 times, 12% p.a.
1995-2009	14 year average	Australian Art up 3.19 times or 9.3%

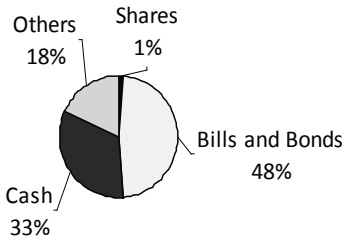
Despite this, The Art Fund did not attract sufficient investment and the listing on Australian Stock Exchange never took off. The main reason for this was the fund's excessive expenditure on salaries and management fees, as well as its inability to attract new capital due to GFC's liquidity squeeze or source efficiently priced artwork.

Remaining with the Australian art market, and focusing on superannuation in particular, a 2010 review of pension fund asset allocation around the world shows some countries, for example, Germany, Switzerland and Japan, with strong existing interest in alternative investments (including art), whilst Australian pension assets are overweight in equities⁴⁸ (see Table 3).

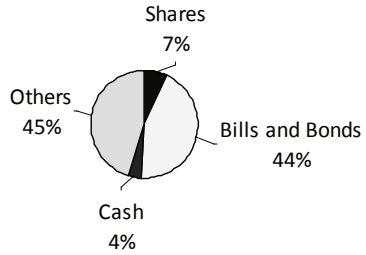
Table 3. Global Pension Funds Asset Allocation⁴⁹

	Shares	Bills and Bonds	Cash	Others
Korea	1	48	33	18
Germany	7	44	4	45
Japan	15	46	8	32
Portugal	18	50	14	18
Iceland	18	60	11	11
Switzerland	21	42	8	29
Sweden	25	63	3	9
Canada	31	42	2	25
UK	45.7	49	3	2.3
US	46	31.7	2	20.3
Ireland	53	25	11	11
Australia	60	14	14	12

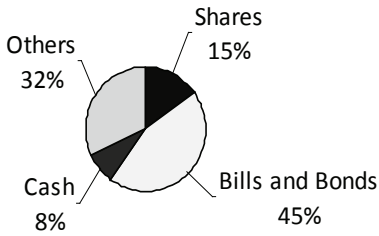
Korea



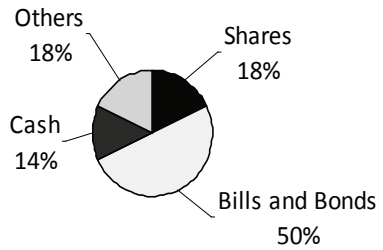
Germany



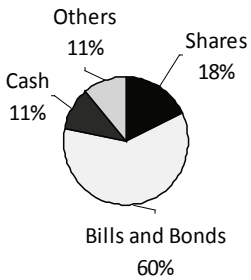
Japan



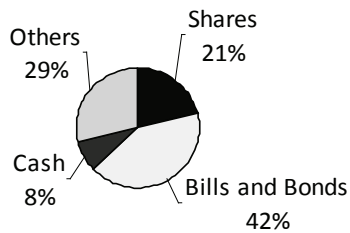
Portugal



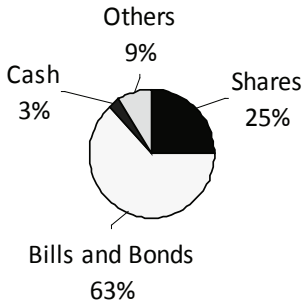
Iceland



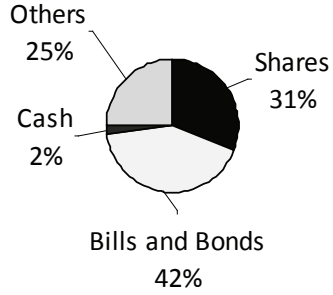
Switzerland



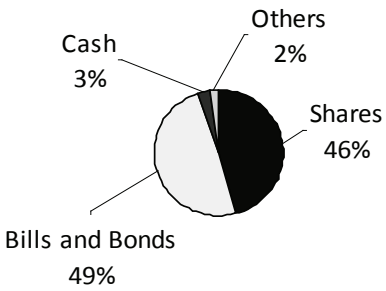
Sweden



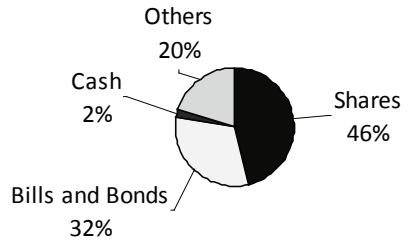
Canada



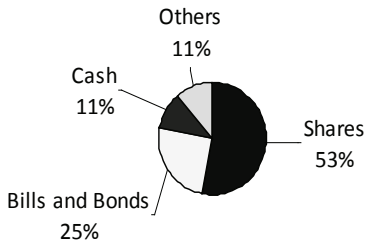
UK



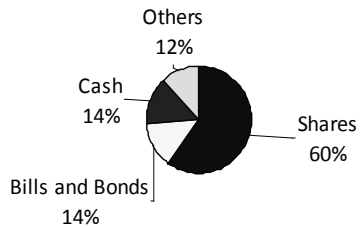
US



Ireland



Australia



Australian superannuation assets are projected to grow significantly over the next 30 years⁵⁰ (Table 4), shifting towards DIY Super (SMSF) - coupled with recent equity market uncertainty and the strong performance of the Australian art market (Figure 13), there is a clear opportunity for art investment funds.

Table 4. Projection of total Australian superannuation assets

	Men	Women	Total	Relative assets	Relative average assets
2010-11	\$915	\$455	\$1,370	50%	63%
2015-16	\$1,310	\$690	\$2,000	53%	66%
2020-21	\$1,830	\$990	\$2,815	54%	69%
2025-26	\$2,460	\$1,365	\$3,830	55%	71%
2030-31	\$3,245	\$1,835	\$5,075	57%	73%
2035-36	\$4,235	\$2,415	\$6,650	57%	74%
2040-41	\$5,500	\$3,145	\$8,645	57%	75%

In the midst of art market failures, the perception of investment in art funds can be a hurdle for its promoters. One of the major concerns for investors is the transparency of art markets. The pricing of artworks is more intangible than that of stocks and bonds, and the market is more susceptible to the subjective forces of current trends and fashion. Related to this is the uncertainty of results. For example, average compound annual return for artworks sold since 2004 was 33% according to the London-based Fine Art Fund, in comparison to the performance of hedge funds that lost 19% in 2008 but gained 20% in 2009⁵².

Despite the failings of some recent endeavours, a number of new and diverse art funds have been announced over the past few years - many branding themselves as “unique” opportunities and many promising investor’s high returns.

A good example of this is London-based company Marquee Capital Ltd, which established the first investment fund devoted to rock and pop mementos⁵³. Started in May 2007, this fund generates profits for shareholders through the capital appreciation

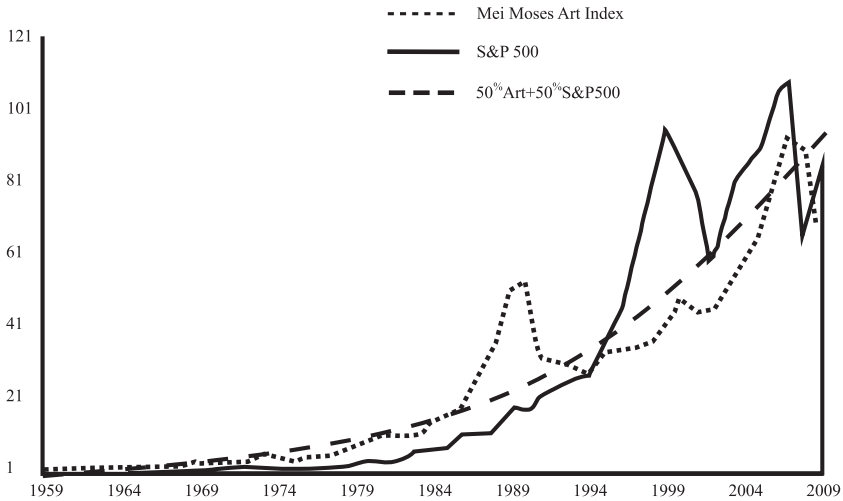


Figure 13. Performance - SP 500 v Mei Moses All Art Index⁵¹

of its collection and income from exhibitions, intending to amass the world's largest portfolio of investment-grade Madonna and non-Madonna memorabilia⁵⁴.

The Fine Art Fund (FAF), based in London, was the brainchild of former Christie's finance director Philip Hoffman. Focused on institutional investors, the aim was to raise US\$350 million for investment in "blue chip art" and to pay dividends by leasing works from its portfolio for display. The idea behind FAF was to capitalise on the increase in art prices stemming from the dot-com profits in 2000.

In 2006, Hoffman claimed compound profits to be 40 percent, with one of the works in the portfolio reaching a value of US\$8 million. Later, speaking in the New York Times in 2009, Hoffman said that the fund had averaged returns of 30 percent each year. "We have averaged the same returns in old masters, Impressionist and modern and contemporary. The biggest growth and the biggest drop have been in the contemporary sector. The most stable has been the old masters market."⁵⁵

The Fine Art Fund is a closed-ended fund - the Fine Art Fund I focuses on the Old Masters, Impressionists, Modern and Contemporary Art. Its strategy of purchasing between \$1 million and \$2 million worth of artworks each year and then putting them back on the market after a year may help to explain the fund's success, because most other funds hold their artworks for between three to seven years before re-selling.

The new Fine Art Fund II focuses on investment in traditional, Modern and Contemporary Chinese art, spanning some 500 years, and is planning to raise its target of \$50 million to \$100 million.

The Indian art market is one of the most popular developing markets for art investment. It has grown rapidly, with income increasing from \$2 million to \$400 million over the past seven years.⁵⁶ One reason for its increasing popularity is that Indian art is less expensive than, for instance, the prices being asked for Old Masters and Impressionists. In an interview with *The Economic Times*, founder of The Fine Art Fund Group Phillip Hoffman asserts that buyers in the two markets have been very different. "The market for Indian art globally is still in its emerging phase and the growth has been much slower compared to that of China. One difference between the two has been that as against the Chinese art market where the demand spurt came from European and American buyers, Indian art until now has largely been bought by Indians living abroad."⁵⁷

Societe Generale Asset Management (SGAM), based in Luxembourg, promoted a US\$25 million Alternative Investment Art Fund in 2007. This was touted as the 'first fund to be backed by a bank,' with initial investment of US\$150 million in the second year and projected annual returns of 15 percent. SGAM's investment policy was to 'invest in modern art using private equity techniques.' The rationale for this fund was the expectation that art prices follow trends that are the opposite of bonds and shares, thus providing risk diversification.

Another success story is Castlestone Management's Collection of Modern Art fund. Based in New York and launched in May 2009, Castlestone manages this mutual fund and follows a 'buy-and hold' strategy specializing in museum quality, post-war works⁵⁸. Investment in this fund starts at US\$ 10,000.⁵⁹

In 2007, an interesting collaboration between the China Contemporary Art Foundation (which holds a collection of more than 3,000 works) and the China Merchants Bank was launched, offering China's 'new-rich' the opportunity for a long-term investment in Chinese contemporary art. Investors with minimum assets of 10 million Yuan pay a deposit for a chosen piece of artwork from the fund, and have a 12-month period to enjoy it before deciding whether to purchase or return it⁶⁰.

Looking to the future, the first closed-end art fund to be authorised by the Irish Financial Services Regulatory Authority is poised to enter the market in May 2010. Anthea Art Investments will launch the Anthea 1 Contemporary Art Investment Fund which will focus entirely on artwork from 1945 to the present, and is targeting EUR 30-40 million at launch.

This fund will close investment shortly after debut and will likely hold a second closing before the end of the year, with the aim of reaching EUR 80 million. The fund will have an eight-year maturity, including a four-year investment period with a EUR 250,000 investment minimum. Despite negotiations with some pension funds, insurance companies and other institutions, it is expected that most investors will be private individuals and family offices⁶¹.

The majority of the works in the fund will be by established artists, some by successful artists from emerging economies, a small percentage will be works by emerging artists, with approximately 20% of fund capital used to make price arbitrage investments by picking up artworks below market value via distressed situations and art auctions.

Two examples of potential entrants to the art investment market are the AC Contemporary Art Fund and the Meridian Emerging Art Markets Fund.

Italian based alternative investment firm, Advanced Capital Art fund (in partnership with auction house Philips de Pury) has advised that they are waiting for the green light from Italian Authorities before starting to market their AC Contemporary Art Fund; however, it has also had difficulty in attracting investors⁶².

Meridian Art Partners established the Meridian Emerging Art Markets Fund in 2008, aimed at the growing number of wealthy art collectors in Asia, Latin America and the Middle East, perceived as less risk-averse than their Western counterparts. Although it was expected that volatile economic times would present an opportunity to buy art more cheaply⁶³, this, along with private bank problems, had the opposite effect of decreasing investor confidence⁶⁴.

When considering the performance of art funds across the world - those that have failed, those few continuing to operate successfully and those poised to launch, it is clear that on the whole, the establishment and subsequent performance of the art fund of today has been heavily impacted by the financial instability of recent years, which further exacerbated the industry challenges of attracting capital and sourcing suitable artworks. This poses the question – where to in the future?

2010 will be a year of continued reshaping in the art market, with auctions expected to remain smaller and private sales likely preferred by many collectors.

In making any projections on the future of the art market, it must be viewed first and foremost in the context of the larger global economy. Whilst valuable insight on the direction of this market can be obtained by tracking it to the performance of other financial assets, care must be taken not to oversimplify this

relationship by establishing ‘rule of thumb’ market lag-times as a basis for investment.

Over the past five years, some hard lessons have been learned, but these all help to facilitate better decision making and paint a clearer picture of art market expectation and structure in 2010.

It was in 2005 that investment in art started gaining traction, due to the timely convergence of several factors, including a substantial increase in art prices. This ignited investment ambitions and heralded a new breed of buyer - the “investor-collector” and the “speculative-collector”; attracted by the glamour of art as an alternative investment in this time of global liquidity excess.

Then came the financial market free-fall that saw a rapid and steep drop in art prices. Those who had argued that the art market operated independently to other financial asset markets were left to ponder the reasons for this fall, whilst other observers had to ask whether the increase in the momentum of the art market in prior years was merely a reflection of the general overstatement seen in so many asset types as generated by a global asset bubble. The most important question at this time however, was forward-looking – had the art market reached rock bottom, and was it showing signs of stabilising?

Market insiders claimed that the subsequent and recent art market upswing was of a completely different nature, with three factors spear-heading the revival and contributing to a shift in market focus: a significant increase in wealthy individuals around the world; the entrance of collectors from the emerging markets (Middle East, Latin America, Russia and Asia) and rising interest in contemporary art among the expanding wealth base in America.

While this argument is partly true, the arrival of new buyers in large numbers does not mean that they could not also leave in large numbers. The art market is fuelled by wealth creation and liquidity, the absence of which can have a sudden and dramatic impact on transaction volume and pricing, as painfully experienced

in the 2008/2009 auction season. Markets can fall abruptly overnight should collectors, “investor-collectors” and “speculative-collectors” change their perception of value, especially in an unregulated, opaque market which is not embedded with an objective, standard valuation methodology.

This vulnerability of the art market can be highlighted by comparing the two-week auction of impressionist & modern and post war & contemporary art in New York in the autumn of 2007 with that of the autumn of 2008 - \$1.6bn against \$729m respectively. Despite comparable quality of auction material, buyer demand was absent which resulted in a dramatic drop in prices and works sold. This market contraction was compounded by lower auction prices and the loss of guarantees, with only \$596m total auction sales in autumn 2009 (less than 40% of the peak).

Most recently, there is a premise that participants are on the sidelines waiting to return when the economy recovers. This assertion needs to be evaluated carefully, as although some fortunes have been dramatically diminished, there is still considerable world-wide wealth. However, the perception of wealth is considerably different now than in 2007, and the “speculative-collector” is likely to have disappeared for the foreseeable future. Several noted economists, including Paul Krugman, have argued that we are undergoing a monumental restructuring of many sectors of the global economy—media, retailing, real estate, automotive and financial services. Will the art market undergo the same transformation?

Consideration must also be given to the decrease in net worth and its negative effect on leading collectors, foundations and institutions, such as the Metropolitan Museum of Art and Harvard University. If such prominent institutions are forced to drastically reduce their spending due to declining endowments and investment income, what does this suggest about the buying capacity of the art industry’s most visible players? And more recently, what will be the ultimate impact of the current debt crises in Dubai on the broader collecting ambitions of that region of the Middle East?

During 2009, the art market was impacted by limited art market liquidity, global deleveraging and financial market turmoil. Interestingly, global financial market upheaval reinforced the long-standing preference of Indian, Chinese and Middle-Eastern collectors to hold real assets (for example, art, real estate and gold). In addition, these emerging economies are recovering faster than those of the US, Japan and Europe. For these reasons, the classical Chinese paintings and works of art market, unlike its western counterparts, has experienced a less severe impact.

Gold prices have recorded record highs, due to concerns about future inflation or a return of financial market instability, and it is those same concerns that are expected to encourage a number of wealthy individuals toward increasing their portfolio allocation to art as an inflation hedge, thus fuelling price increases in more well known and higher quality works – the more conservative old masters and impressionist & modern classics.

2010 will see continued reshaping of and improvement in the art investment market, following prior year shifts in global investment trends. The art market cannot rely on profit increasing generally across the board; rather, success is expected to be found at smaller, private auctions of high quality works that have a more conservative appeal. Art can therefore still be seen as an extremely valuable asset and a ‘must-hold’ for both the connoisseur and the investor-collector.

Evidence of this success in high-quality works can already be seen early in 2010, with a very strong start to art sales world-wide.

In what is being seen to signal the recovery of the top end of the art market, total revenue for Christie’s and Sotheby’s Contemporary Art sales has increased by 255%, compared to February 2009 (combined revenue of \$79.5m in February 2010 vs. £22.3m from the same sales in 2009)⁶⁵.

In 2009, contemporary art sales in London were well down, and the three auction houses were only able to achieve £32.8m for six

sales. So far this year, volumes have increased, with more than £116m worth of contemporary art selling over five days.⁶⁶

Some notable sales include the ‘stupendous price of £65m’ fetched in London by Giacometti’s “L’Homme qui marche 1” (1961) and the fierce bidding for 18th century Chinese pieces in Hong Kong at Sotheby’s 2010 Spring Sale, where world auction records tumbled, and some items sold for up to five times their estimated selling price⁶⁷.

It appears that major works are once again appearing in auction rooms after eighteen month hibernation⁶⁸. Indeed, Sotheby’s international head of Chinese ceramics and works of art confirmed that interest in Chinese works of art was booming, and expressed concern that supply was not able to keep up with demand⁶⁹.

CONCLUSION

Art will always be a subjective investment, influenced by the trends of the time. However, it is still a tangible asset, with low correlation to stockmarkets and therefore the perfect alternative market in which to diversify one's investment portfolio.

The large allocation of high net worth individual capital into art, and the predicted increase in the number of such individuals across the world, is expected to lead to a far greater appetite and demand for art investments.

This same scenario is predicted too for Australian superannuation funds. There is large diversification potential for an industry long over-exposed to equities, at a time when total superannuation assets are increasing (as well as the shift to self-managed superannuation funds) and when the Australian art market is performing strongly.

Further, the art market has long held a prohibitively high 'barrier to entry', with substantial amounts of cash required for establishment and regulatory requirements before outlaying a single dollar on the artworks themselves.

The advent of art funds and art syndicates in recent times provides a more efficient and less expensive option for the art investor, without the need to engage in the regulatory structure.

As seen at the start of 2010, demand for high quality artwork is particularly strong and this is expected to continue to grow.

Like the global art market itself, art investment funds have experienced a difficult few years, but if lessons can be learned from the global economic fall-out and associated investor behaviour, they stand to thrive as the combination of the factors described above drives the art market still further upwards in 2010.

APPENDIX 1.

YOUR INVESTMENT RISK PROFILE

What Investor Style are you? This Investment Risk Profiler helps you in determining the investment style that is most appropriate for you. It draws different factors together by helping you understand how you feel about risk. It provides guidelines that may help you determine how to allocate the funds you have available for investing among the major asset classes (i.e. shares, property, fixed interest, art and cash).

This Investment Risk Profiler tool does not constitute a recommendation or statement of opinion about investor style and is not intended to be relied upon for the purpose of making a decision in relation to a financial product.

Please remember that this risk tolerance questionnaire has been designed to help you evaluate your risk profile and that, given the answers to the above questions, your risk profile may be in the indicated sector. If you feel comfortable with the analysis provided, then your financial adviser can use it to devise an appropriate investment portfolio. If you don't agree with the analysis, or want to ask some questions about it, or for advice about investing, you should consider obtaining advice from a financial adviser.

1. Which of the following best describes your current stage of life?	Points
a) Single with few financial burdens. Ready to accumulate wealth for future short term and long term goals.	5
b) A couple without children. Preparing for the future by establishing a home. Expecting to have or already have a high purchase rate of household and consumer items.	4
c) Young family with a home. You have a mortgage and childcare costs and maintain only small cash balances.	3
d) Mature family. You are in your peak earning years and your mortgage is under control. You both work and you may or may not have children that are growing up or have left home. You're ready to start thinking about your retirement years.	5
e) Preparing for retirement. You own your home and have few financial burdens; you want to ensure you can afford a comfortable retirement.	2
f) Retired. You rely on existing funds and investments to maintain your lifestyle in retirement. You may already be receiving a Government pension and/or Superannuation pension.	1
2. How familiar are you with investment matters?	Points
a) Not familiar at all with investments and feel uncomfortable with the complexity.	0
b) Not very familiar when it comes to investments.	1
c) Somewhat familiar. I don't fully understand investments, including the share market.	2
d) Fairly familiar. I understand the various factors which influence investment performance.	3
e) Very familiar. I use research and other investment information to make investment decisions. I understand the various factors which influence investment performance.	7
3. How long have you been investing, not counting your home or bank type deposits?	Points
a) 3 years or more.	5
b) Up to 3 years.	2
c) This is my/our first investment.	1
4. How long would you invest the majority of your money before you think you would need access to it? (Assuming you already have plans in place to meet short term cash flow and/or emergencies.)	Points
a) In 2 years or less.	1
b) Within 3-5 years.	3
c) Within 6-10 years.	7

d) Not for 10 + years.	10
5. Once you start using your invested money, how long would you need it to last?	Points
a) Over a period of 2 years or less.	0
b) Over a period of 3-5 years.	1
c) Over a period of 6-10 years.	3
d) More than 10 years/Retirement.	5
6. In October 1987, the Australian share market fell more than 40% during the month. If the share component of your portfolio fell by 40% over a short period, such as a month, would you:	Points
a) Sell all of the investments. You do not intend to take risks.	1
b) Sell a portion of your portfolio to cut your losses and reinvest into more secure investment sectors.	3
c) Hold the investment and sell nothing, expecting performance to improve.	5
d) Invest more funds to lower your average investment price.	7
(If you have experienced a fall like this, choose the answer that corresponds to your actual behaviour.)	
7. If your investments fell by more than 6% over a short period, would you:	Points
a) Sell all of the remaining investment.	1
b) Sell a portion of the remaining investment.	3
c) Hold your investments and sell nothing.	5
d) Invest more funds. You can tolerate short term losses in expectation of future growth.	6
(If your portfolio has experienced a drop like this, choose the answer that corresponds to your actual behaviour.)	
8. The table below shows the highest one-year gain and highest one-year loss on three different hypothetical investments of \$10,000. Given the potential gain or loss in any one year, where would you invest your money?	Points
a) Fund A – Highest Gain: \$593 Highest Loss: -\$164	1
b) Fund B – Highest Gain: \$1,921 Highest Loss: -\$1,020	3
c) Fund C – Highest Gain: \$4,229 Highest Loss: -\$3,639	5
9. Which one of the following statements describes your feelings towards choosing an investment?	Points
a) I would prefer investments with little or no fluctuation in value and have a low degree of risk association with them. I am willing to accept the lower return associated with these investments.	1

b) I prefer to diversify with a mix of investments that have an emphasis on low risk. I am happy to have a small proportion of the portfolio invested in assets that have a higher degree of risk in order to achieve a slightly higher return. I am prepared to accept a negative investment return of 1 in 10 years.	2
c) I prefer to have a spread of investments in a balanced portfolio. I am happy to have a negative return of 1 in 7 years.	4
d) I prefer to diversify my investments with an emphasis on more investments that have higher returns, but still having a small amount of low risk investments. I am prepared to accept a negative return of 1 in 5 years.	7
e) I would only select investments that have a higher degree of investment price fluctuation so that I can earn higher long term returns. I am happy to accept a negative return of 1 in 3 years in order to achieve this goal.	12

10. How secure is your current and future income from sources such as salary, pensions or other investments?	Points
a) Not secure.	2
b) Somewhat secure.	3
c) Fairly secure.	4
d) Very secure.	5

Only answer questions 11-13 if you are intending to trade options or derivatives

11. Are you proposing to sell options positions to open, that is, writing positions?	Points
a) For income purposes over stock you hold;	-3
b) Selling puts with a view to purchasing stock at a later date;	3
c) As a trading strategy to lock in 'time decay', without necessarily holding the stock;	5
d) To generate immediate premiums and monitor to retain premiums, without holding the stock and holding minimal cash lodged.	7

12. What percentage of collateral utilization (stock/cash) do you deem appropriate to trade options?	Points
a) Greater than 90%	10
b) 75%	5
c) 50%	3
d) Less than 20%	0

13. If you suffer an unrealised loss on an options position, would you:	Points
a) Roll the position to the next series;	5
b) Move the position to a more in the money series to achieve a greater premium;	10
c) Sell increased positions;	15
d) Close the position	0

Only answer questions 14-15 if you are intending to trade CFDs or futures

14. As CFD's are a highly leverages product are you	Points
a) Expecting to trade them as a small part of your portfolio, e.g. less than 10%;	2
b) Between 10-50%;	5
c) Greater than 50%;	10
d) They will be the only product I trade.	15

15. What trading CDF's, will you trade	Points
a) With the view to hedge your underlying portfolio;	2
b) As a means to increase returns on your portfolio;	5
c) In a speculative nature to take advantage of opportunities;	10
d) In very short term timeframes as a trader.	15

Your score:

Add up the points you scored for each answer. Based on the total points, you may compare your score with the range of Profiles described below.

Total points

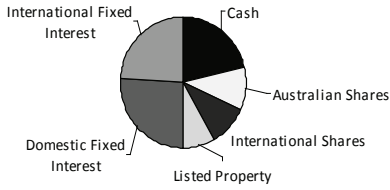
Indicative Investor Profile	Score	Description
Conservative	0-18 points	You are a conservative investor who does not wish to take any investment risk. Your priorities are the safeguarding of your investment capital. You are prepared to sacrifice higher returns for peace of mind.

Moderately Conservative	19-25 points	You are a moderately conservative investor who is prepared to accept a small amount of risk. Your priority remains the preservation of capital over the medium to long term. You may have some understanding of investment markets; however, you cannot afford to take any chances with your capital.
Balanced	26-44 points	You are a balanced investor with some understanding of investment market behaviour and can accept some short term risk to your capital. You do not wish to see all of your capital eroded by tax and inflation and are prepared to take a small short term risk in order to gain longer term capital growth.
Assertive	45-55 points	You are an assertive investor who understands the movement of investment markets. You are most interested in maximizing long term capital growth, although you do not wish to make unbalanced investment decisions. You are happy to sacrifice short term safety in order to maximize long term capital growth.
Aggressive	56+ points	You are an aggressive investor. You are prepared to sacrifice your investment capital in pursuit of the highest long term capital growth investment. You are most interested in reducing your taxable income and have an understanding of the behaviour if investing in markets.

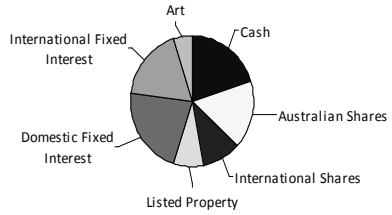
	Cash	Australian Shares	International Shares	Listed Property	Domestic Fixed Interest	International Fixed Interest	Art	Total Portfolio Allocation
Conservative	21	11	10	8	26	24	0	100
Moderately Conservative	20	17	10	8	22	18	5	100
Balanced	5	30	20	10	17	8	10	100
Assertive	5	30	27	10	10	8	10	100
Aggressive	2	32	29	10	9	3	15	100

GRAPHICAL REPRESENTATIONS OF INVESTOR PROFILES

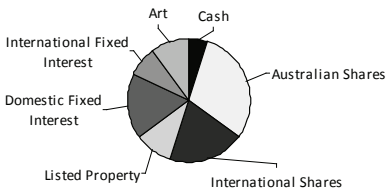
Conservative



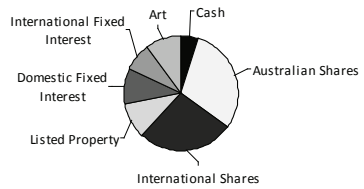
Moderately Conservative



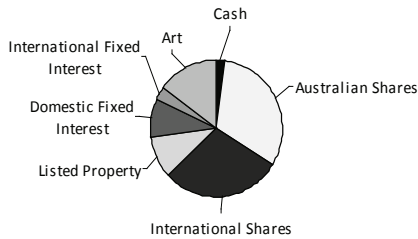
Balanced



Assertive



Aggressive



DISCLAIMER

All content is protected by Copyright and may not be copied or reproduced in whole or in part by any means, including photocopying and electronic transmissions, without prior written authorisation. All rights are reserved. With respect to content (including text and images) from the book, direct copying or quotation placed in a facsimile or email message, in a post on any website (including internet message boards, blogs, social networking sites and public discussion forums), or in an article published in other mass media, is not allowed; but citations or references to such content by hyperlinks to pages and image-files on the hosting website are permitted.

Before relying on the information in this book, users should carefully evaluate its accuracy, currency, completeness and relevance for their purposes, and should obtain professional advice relevant to their particular circumstances. The owners, developers and associated parties cannot guarantee nor assume any legal liability or responsibility for the accuracy, currency or completeness of the information or material.

This book is not a substitute for independent professional tax, investment, social security or legal advice. Whilst many taxation, legal and investment matters are discussed in length, this book serves as the writer's interpretation of current laws and regulations, without specific advice on any personal or corporate

requirements. Use of any information from this book or any other book or web site referred to is for general information only and does not represent advice either expressed or implied.

You are encouraged to seek professional tax, legal or investment advice. No warranties or endorsements by either ASIC, APRA, ATO or other government bodies as to the accuracy or value of the information provided is implied from possession of this book. Accordingly, developers, owners and affiliates disclaim that the information provided should not be treated as advice. Furthermore, it is a strict condition of the that any individual reading the book recognizes and accepts unreservedly that all information, analyses, projections, forecasts, expectations, or outcomes relating to past, present, or future financial markets performance, economic activity, or investment or trading instruments, are provided exclusively for academic purposes and that such information must not in any way be construed as general or personal advice to invest or trade in any financial market or security. All references to and presentation of analyses, projections, forecasts, expectations, or outcomes relating to past, present, or future financial markets performance, economic activity, or investment or trading instruments, are provided information in this book or related websites for academic purposes only and must not in any way be construed as specific or general advice to invest or trade in any financial market or security.

The foregoing applies also to correspondence (including private emails) with the developers or the book designer to posts on other websites (including internet message boards and public discussion forums), and to articles published in other mass media. Developers or publishers shall not be held liable for any losses incurred by anyone who follows or acts on the opinions, views, or forecasts expressed in any form in this book, on any other websites or from individuals connected by hyperlink to or from this website. Anyone reading this book is solely responsible for their interpretation of its contents and for their own decisions and actions with regard to trading or investing in financial markets.

Examples quoted from analyses, projections, forecasts, expectations, contingent scenarios, or investment or trading strategies which have been deemed successful, or which produced accurate outcomes in terms of price, direction, or timing objectives, or position-related profitability, are presented for illustrative purposes only. They are not intended to be an exhaustive listing of all projections, forecasts, expectations, or contingent scenarios presented in the book, newsletters or in posts to public internet forums. Many of those not included in the highlights presented information in this book or related websites were also successful in terms of achieving their price, direction, or timing objectives, but some of the forecasts did not meet their anticipated targets. You should make your own enquiries before entering into any transaction on the basis of the information or material on this website. Please ensure you contact an adviser directly to discuss your particular circumstances and how the information provided applies to your situation.

Past performance is not indicative of future performance, and trading in securities and derivatives (e.g. Equities, futures and options) involves substantial risks. All readers should consult their own licensed Investment Adviser and/or Stockbroker, Insurance Broker, Solicitor, Tax Agent, Registered Real Estate Agent, Mortgage Broker, Art Dealer, Financial Planner or other specialist before placing funds at risk or attempting to implement any of the strategies discussed, and should always employ prudent money management policies and practices appropriate to their own particular circumstances.

REFERENCES

¹ Mamarbachi, R., Day, M., Favato, G., 2008, *Evaluating Art as an Alternative Investment Asset*, Journal of Financial Transformation March 26, 2008, p 2.

² Worthington, A., Higgs, H., 2008, *Australian fine art as an alternative investment*, Accounting Research Journal, vol. 21, no. 1, pp. 55-66.

Worthington, A., Higgs, H., 2006, *A note on financial risk, return and asset pricing in Australian modern and contemporary art*, Cultural Economics, vol. 30, no. 3, pp. 73-84.

Worthington, A., Higgs, H., 2005, *Financial returns and price determinants of the Australian art market 1973-2003*, The Economic Record, vol. 81, no. 253, pp. 113-123.

Worthington, A., Higgs, H., 2004, *Transmission of returns and volatility in art markets: A multivariate GARCH analysis*, Applied Economics Letters, vol. 11, no. 4, pp. 217-222.

Worthington, A., Higgs, H., 2004, *Art as an investment: risk return and portfolio diversification in major painting markets*, Accounting and Finance, vol. 44, no. 2, pp. 257-271.

Worthington, A., Higgs, H., 2003, *Art as an investment: Short and long-term comovements in major painting markets*, Empirical Economics, vol. 28, no. 4, pp. 649-668.

³ ABN AMRO Bank, 2005, *Art Funds Initiative: 2005 Global Road Show*.

⁴ Mei, J.P and Moses, 2002, M, *Art as an Investment and the Underperformance of Masterpieces*, American Economic Review, December 2002.

⁵ Eckstein, J, 2006, *Treating Art as an Asset Class*, Investing in Art, Jeremy Eckstein and Associates, London.

⁶ Frey, B, 2003, *Art Markets and Economics: Introduction*, University of Zurich, Journal of Cultural Economics, Vol. 21, 2003

⁷ Deitch, J, 1989, *The Business of Art*, Prentice Hall, N.J.

- ⁸ Campbell, R., 2005, *Art as an Alternative Asset Class*, Maastricht University - LIFE Research Paper No. WP05-001 February 2005
- ⁹ Ralevski, O. *North American Art and Modern Forms of Investment*, December 2007, pp. 57, Working Paper, Edinburgh University Business School
- ¹⁰ Source: Merrill Lynch, Reuters, Mei Moses All Art Index , Credit Suisse; Indexed performance in USD (31.01.04 = 100)
- ¹¹ Watson, P. *The Rise of the Modern Art Market* From Manet to Manhannan, 1992, pp. 425.
- ¹² Grant, D, 2006, *Art investment companies begin to make purchase*. Main Antique Digest, 20th September, 2006; also Eckstein, J, 2006, *Treating Art as an Asset Class*, Investing in Art, Jeremy Eckstein and Associates, London; and Groysberg, B, Podolny, J, Keller, T, 2006, *Fernwood Art Investments: Leading in an imperfect marketplace*, Harvard Business School Publishing, Cambridge, M.A., 2006.
- ¹³ Ralevski, O. *North American Art and Modern Forms of Investment*, December 2007, pp. 57, Working Paper, Edinburgh University Business School
- ¹⁴ ABN AMRO Bank, 2005, Art Funds Initiative: 2005 Global Road Show.
- ¹⁵ Capgemini Lorenz, curve analysis, 2008, www.ml.com/media/100472.pdf
- ¹⁶ Oliver Wyman Report *The Future of Private Banking* 2008, Capgemini and Merrill Lynch. *World Wealth Report 2008*.
- ¹⁷ Markowitz, H., 1952, *Portfolio Selection*. *Journal of Finance* **7** (1): 77–91.
- ¹⁸ Sharpe, W., 1964, *Capital asset prices: A theory of market equilibrium under conditions of risk*. *Journal of Finance* **19** (3): 425–442.
- ¹⁹ Brinson, G., Hood, R., Beebower, G., 1986, *Determinants of Portfolio Performance*, *The Financial Analysts Journal*, July/August 1986 and Brinson, G., Singer, B., Beebower, G., 1991, *Determinants of Portfolio Performance II: An Update*, *The Financial Analysts Journal*, **47**, 3 (1991).
- ²⁰ Schweitzer, K, 2008, *Interview with Mr. Schweitzer, Head of US Art Banking*, 11th of January, 2008.
- ²¹ Jyrämä, A, 1999, *Contemporary Art Markets: Structure and Practices*, Helsinki School of Economics and Business Administration.
- ²² Jyrämä, A, 1999, *Contemporary Art Markets: Structure and Practices*, Helsinki School of Economics and Business Administration.
- ²³ Tarascio, V. 1988, *Kondratieff's theory of long cycles*, *Atlantic Economic Journal*, Springer Netherlands, Volume 16, Number 4 / December.

- ²⁴ Abdini, P, 2007, *Interview with Mr. Abdini, Director, Bellamy's*, 27th of September, 2007.
- ²⁵ A more comprehensive description of the six inefficiencies of the art market is set out in: Keller, T. & Groysberg, B. & Podolny, J. *Fernwood Art Investments: Leading in an Imperfect Marketplace*, Harvard Business Review, September 24, 2004, pp. 4-5.
- ²⁶ Vallikappen, S., 2008 *SEBI raps art funds*, [Indian Art News](#).
- ²⁷ Art Trading Fund, 2007, *Art Trading Fund Investor Report*, August- October, 2007.
- ²⁸ Channel Islands Stock Exchange <http://www.cisx.com>
- ²⁹ FTAdviser.com, December 17, 2009.
- ³⁰ Johnson, S., 2007, *Hedge fund sees art as exotic asset class*, [The Financial Times](#), June 15, 2007
- ³¹ Burroughes, T., 2008, *Advertising Tycoon Charles Saatchi to Advise Art Hedge Fund*, [Forbes](#), May 23, 2008.
- ³² Art Trading Fund, 2007, *Art Trading Fund Investor Report*, August- October, 2007, also in FTAdviser.com, *Art Investment firm to close*, Rory Jones, December 17, 2009.
- ³³ Taylor, *Seeking a hedge for art*, [The New York Sun](#), August 13, 2007.
- ³⁴ FTAdviser.com, *Art Investment firm to close*, Rory Jones, December 17, 2009.
- ³⁵ Fama, E., 1970, *Efficient Capital Markets: A Review of Theory and Empirical Work*, Volume 25, Issue 2, pp.383-417 American Finance Association, Journal of Finance; also Fama, E. F., and K. R. French (1988a): *Dividend Yields and Expected Stock Returns*, Journal of Financial Economics, 22(1), 3–25; and Fama, E. F. (1981): *Stock Returns, Real Activity, Inflation, and Money*, *American Economic Review*, 71(4), 545–565.
- ³⁶ Timmermann, A., Granger, C., 2004, *Efficient market hypothesis and forecasting*. International Journal of Forecasting, v20. 15-27.
- ³⁷ Goyal, A., Welch, I., 2003, *Predicting the Equity Premium with Dividend Ratios*, *Management Science*, 49(5), 639–654.
- ³⁸ Campbell, J., Shiller, R., 1988, *Stock Prices, Earnings, and Expected Dividends*, Journal of Finance, 43(3), 661–676.; also in Campbell, J., Shiller, R., 1989, *The Dividend-Price Ratio and Expectations of Future Dividends and Discount Factors*, Review of Financial Studies, 1(3), 195–227.
- ³⁹ Claus, J., Thomas, J., 2001, *Equity Premia as Low as Three Percent? Evidence from Analysts' Earnings Forecasts for Domestic and International Stock Markets*, Journal of Finance LVI, 1629-1666; also see Brown, L., 1993, *Earnings Forecasting Research: Its Implications for Capital Market Research*, International Journal of Forecasting 9, 295-320

⁴⁰ Cochrane, J., 1997, *Where is the Market Going? Uncertain Facts and Novel Theories*, Federal Reserve Bank of Chicago - Economic Perspectives, 21(6), 3–37.

⁴¹ Cremers, K., 2002, *Stock Return Predictability: A Bayesian Model Selection Perspective*, Review of Financial Studies, 15(4), 1223–1249.

⁴² Chanel, O., Gerard-Varet, L., Ginsburgh, V., 1996, *The Relevance of Hedonic Price Indices*. Journal of Cultural Economics, 20(1):1-24.

⁴³ Daniel, K., Titman, S., 2000, *Market Efficiency in an Irrational World* (January 2000), NBER Working Paper No. W7489.

⁴⁴ *Osian's Art Fund Fails in Art of Investing*, <http://www.livemint.com/2009/12/10003710/Osian8217s-art-fund-fails-i.html>, December 2009.

⁴⁵ *Osian Art Fund failed to live up to expectations, says Neville Tuli*, <http://www.suchetadadal.com/?id=3a0eca15-8928-3995-4b445b5de80e&base=sections&f>, January 2010.

⁴⁶ The Arts Trust PDS, http://www.huntleygroup.com.au/documents/FINALPDSApr08_000.pdf.

⁴⁷ *Australian Fine Art as Alternative Investment* by Worthington, A. and Higgs, H., Report 05/02, 2004; *Investors Turn to Art for More Attractive Returns*, 24/05/2008, p.80; Van Eyk Research, Reuters; AMI returns sourced from Dedman, R., 2009, *The Australian Art Market Movement Handbook 2009*, Menzies Brands

⁴⁸ Source: Artnet, Capgemini, OECD Report 2008, Australian Financial Review, 24 Feb 2010, p.5.

⁴⁹ Source: Artnet, Capgemini, OECD Report 2008, Australian Financial Review, 24 Feb 2010, p.5.

⁵⁰ Treasury projections using RIMGROUP, Projection of total Australian superannuation assets by gender, \$AUD, billion.

⁵¹ Performance of All Art vs S&P 500 total return 1959-2009. Mei Moses Index (www.artasanasset.com), MSCI.

⁵² *Banker waits out Global Crisis, Auction Slump to test Art Fund*, <http://www.bloomberg.com/apps/news?pid=20601088&sid=awNUMDZUbLC4>, February 2010.

⁵³ *Madonna's Bra, Clapton's Guitar Targeted by Art Investor Funds*, http://www.bloomberg.com/apps/news?pid=20601014&sid=aEFEhsFWo_m8, August 2008.

⁵⁴ Source: <http://www.marqueecapital.com>.

⁵⁵ New York Times, "Art Funds Feel a Revival as Economy Thaws Out", Nazanin Lankarani, September 5, 2009.

- ⁵⁶ Sinha, V., 2008, *Hoffman raises \$25 m Indian Fine Art Fund*, The Economic Times, January 17 2008.
- ⁵⁷ Owne, *Indian Fine Art Fund Launched*, The Times of India, 6 Feb 2008.
- ⁵⁸ Source: www.collectionofmodernart.co.uk
- ⁵⁹ *Castlestone Offers Art Fund to the Masses*, (<http://www.finalalternatives.com/node/7630>), April 2009.
- ⁶⁰ *CMB Launched Art Banking in China* (<http://english.people.com.cn/90001/90782/91341/6675370.html>), June 2009
- ⁶¹ *Swiss Firm Readies first Irish-Regulated Art Fund*, <http://www.absolutereturn-alpha.com/Article/2366347/Swiss-Firm-Readies-First-Irish-Regulated-Art-Fund.html>, January 2010.
- ⁶² *Art Funds – Who’s Left Standing?*, <http://www.artmarketmonitor.com/2009/04/09/art-funds-whos-left-standing>, April 2009.
- ⁶³ *Art Fund Investors Expect to Raise \$25M*, <http://www.wealth-bulletin.com/home/content/1050290201>, February 2008
- ⁶⁴ *Downturn Hits Art Investment Funds*, <http://www.theartnewspaper.com/articles/Downturn-hits-art-investment-funds/17200>, April 2009.
- ⁶⁵ Contemporary Art sales in London: excellent results, <http://web.artprice.com/AMI/AMI.aspx?id=NzQwOTY2NzM5Mzg3NTk=>, February 2010.
- ⁶⁶ *The Art Market: A Record-Breaking Giacometti*, <http://www.ft.com/cms/s/2/82000aec-11e4-11df-b6e3-00144feab49a.html>, February 2010.
- ⁶⁷ *Sotheby’s Chinese art auction breaks world records*, <http://www.telegraph.co.uk/culture/art/7569714/Sothebys-Chinese-art-auction-breaks-world-records.html>, April 2010.
- ⁶⁸ Contemporary Art sales in London: excellent results, <http://web.artprice.com/AMI/AMI.aspx?id=NzQwOTY2NzM5Mzg3NTk=>, February 2010
- ⁶⁹ Sotheby’s Chinese art auction breaks world records, <http://www.telegraph.co.uk/culture/art/7569714/Sothebys-Chinese-art-auction-breaks-world-records.html>, April 2010.