FINANCIAL PLANNING

Art is an Asset

For love or money, art as an alternative investment can enhance your clients' portfolios.

By Jenny Sherman

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After selling his company and making a substantial fortune, an advisor's client wanted to decorate his new home with art that would grow in value. His advisor had no idea how to develop a collection of investment-grade art, but brought in Artvest Partners, a New York-based firm that provides guidance to private collectors, investors, family offices, institutions and financial advisors.

"They were at a loss," says Artvest co-founder Michael Plummer. The advisor was financially savvy, but ignorant about the art market. "He came to us because he wanted to spend his [client's] money wisely."

More boutique firms that provide wealth managers with financially based art market analysis are cropping up, and a clutch of new art-focused investment funds are launching. Financial advisors with a certain kind of client base need to be able to describe the risks and rewards of art investing, the investment vehicles available and how to find qualified experts if you don't know the difference between Manet, Monet or Mondrian.

PRETTY PROFITS

Throughout history, art generally has been a dependable investment. "In Europe and the Middle East and Asia, art for centuries has been considered an important store of value, an asset," Plummer says. That was the case in America until the Great Depression, when real estate started to become a more stable asset and art collecting seemed like a hobby for the wealthy.

The recent recession has turned Americans' thinking once again toward art. Despite the weak economy, art has been doing relatively well. The art market fell 4.5% in 2008, according to the Mei Moses All Art Index, which analyzes the performance of fine art at public auction. By comparison, the S&P 500 plunged 37%. Artvest estimates that international art sales increased 27.2% in 2010, with transactions amounting to $57.4 billion.

But during turbulent times, art can also be a risk. Buying or selling a piece by Georgia O'Keeffe is in no way like trading 1,000 shares of ExxonMobil. While most securities can be bought or sold in the blink of an eye, art is relatively illiquid. In addition, condition, provenance, scarcity and any number of variables can contribute to vastly different valuations over time. Art offers little regulation, market transparency or standardized valuation mechanisms, all of which can scare off investors.

With risk, however, comes the potential for reward. These characteristics offer significant opportunities for arbitrage if investors know what they're doing.

ART AS DIVERSIFICATION

There are three D's in the art world - death, divorce and debt - that prompt people to sell art collections, Plummer notes. But interest in art as an asset class has added a fourth D to the mix: diversification.

Alternative asset classes are gaining ground as a way to spread risk across many types of investments. Last year's Capgemini Merrill Lynch World Wealth Report delineated six categories of alternative assets it called "passion investments," including collectibles such as wine, coins and jewelry. Art was the most popular of these, with 29.8% of advisors surveyed reporting that their clients viewed it as a way to grow wealth.

"It's no longer enough to go to a client and say, 'Okay, let's put 60% in stocks and 40% in bonds' - there're more than just two buckets," says Enrique Liberman, chairman of the art law practice group of Tannenbaum Helpern Syracuse & Hirschtritt in New York City, and chairman of the Art Fund Association, a trade group of the art investment industry. "They're doing their clients a disservice if they're not affording them access to alternative investments."

Many clients see art as a diversification tool, according to John Arena, senior vice president at U.S. Trust, Bank of America Private Wealth Management, which offers art-backed financing options for high-net-worth clients' art collections. Randall Willette, the founder and managing director of London-based consultancy Fine Art Wealth Management, adds that many clients want "to diversify their investment portfolios into so-called real asset classes - assets that have a tangible value, that are rare and store value - particularly in times of uncertainty, as we are in now."

Even if you're relying on art finance experts, learning more about the art market is easy by checking out publications such as Art+Auction and ARTnews; talking to gallery owners, curators and dealers, and visiting auction houses and museums. A variety of art databases (artnet.com and artprice.com), market research sources (ArtTactic.com) and indexes (Mei Moses and Skates Top 5000) are filled with robust art transaction data.

HOW TO INVEST

There are many ways to enjoy art, but only a handful of ways to invest: a personal collection, a fund or a club. Here's how to get started:

• Collect what you love. People who derive emotional satisfaction from seeing art in their home are collectors. They need to know that creating a collection whose value will grow requires time, research and deep experience with the art market, as well cash to purchase, insure, curate and house their pieces. "You're lucky if you can get one great work of art for $500,000 - you'd probably only get one or two subprime works," Liberman says. "You would be very, very limited in your investment strategy by doing that." The more reliable performers in the art market - works by blue chip artists such as Picasso and Modigliani, for example - are hard to come by and pricier.

Contemporary artwork by living artists is risky from an investment perspective. And if your client is an art dilettante, recommend that he acquire works without expecting them to grow more valuable. "There's nothing wrong, and in fact a lot right, with acquiring a great original work of art from a local emerging artist that has gallery representation, and spending a disciplined amount of $5,000 to $10,000," says Sandy Kemper, chairman of the Collectors Fund, an art investment fund. But do so, he says, primarily for pleasure. "I think it's fairly risky to acquire if you're focused on financial return."

• Share the wealth. Forming a small, private art investment collective with some like-minded investors is an option to try to generate returns. "These are partnerships of two, five, 10 people who know one another and create a legal structure to own multiple pieces of art," Plummer says. He might assist the wealth manager for a family office or a small group of investors to create a very focused, customized art investment. "They'll engage someone like ourselves to structure the partnership or LLC to basically manage the investments or assets as an investment, not as a collection," he says.

Art investment collectives not only pool resources, they are also a good option for buyers who want to learn the ins and outs. "It creates a much more personal approach to managing a portfolio of art," says Willette, whose firm helps clients create investment collectives and find the experts to manage them.

• Diversify risk. Art investment funds are privately offered, managed by art market experts and investment advisors, that buy artwork and generate returns upon its sale. One of the first such funds was started in 1904, when Parisian financier AndrÃ© Level invested in pieces by Picasso and Matisse. More recently, the British Rail Pension Fund, between 1974 and 1999, delivered an aggregate return of 11.3% per year compounded, based on an initial investment in more than 2,500 works of art over a six-year period.

The last several years have seen a handful of successful funds emerge.