Institutional Investor

Art Funds Bidding to be Considered a Real Asset Class

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Britain's Railways Pension Scheme faced a quandary. It was 1974, and U.K. inflation was running above 30 percent, while London's stock market was tumbling. Showing a bold creative streak, RPS unearthed an asset class that offered solid real returns in an inflationary environment: fine art.

The fund invested £40 million ($65 million) over six years in Old Masters, Chinese art, and antiquities (but no chancy contemporary works). Over eight further years the portfolio generated total art sales of £179 million, for an average annual return of 11.3 percent, or 4 percentage points better than inflation.

Although the RPS concluded that investing in art was "successful [and] met the objective of safeguarding pensions," it dropped the program in the mid-1990s when hedge funds and other alternatives became available.

But like some neglected minor masterpiece, art may be on the verge of rediscovery as an asset class. Wealthy collectors, of course, have always prized paintings for their fiscal as well as their aesthetic allure. But now some half dozen art portfolios structured much like private equity funds (with comparable fees) are trying to redefine art as an official alternative asset class, not only for private investors but also for institutional ones.

"When you say 'art' to a large institutional investor, their eyes glaze over," allows Enrique Liberman, president of the newly formed Art Fund Association. "But art is an established asset class, and our central thesis is that a properly structured art fund can produce significant returns."

"Art funds are a relatively new concept," adds Michael Plummer, a former Christie's auction house executive who is a principal at Artvest Partners, a New York financial adviser focused on art. "We draw the analogy to REITS (real estate investment trusts) and hedge funds when they were young.” He estimates the assets of the global art fund market at between $300 million and $800 million.

Like any other portfolio managers, the heads of art funds strive to generate alpha through superior knowledge of a market — in their case, the arcane world of art trading. One of the more venerable art investment funds, London’s Fine Art Fund Group, reported in May that its first two funds have been averaging a roughly 25 percent annual return since their inception seven years ago. The firm spreads its assets among old masters, impressionists and modern art, along with a limited allocation to high risk/high return contemporary (post-1985) artists. For instance, Fine Art bought a modern art work (it won’t disclose which one) for $1.1 million in 2006 and sold it 17 months later, at a market peak, for $2.6 million.

Art funds are a good way to access art as an asset class, contends Artvest’s Plummer, because they offer diversification, expertise and the collective resources to purchase major pieces. “It is difficult to buy a great painting unless you have very, very deep pockets,” he notes.

Art funds are mostly too new to have credible track records. However, the Mei Moses World All Art Index, a broad industry benchmark based on auction sales, registers gains of about 30 percent a year, on average, in 1985–’90 and some 20 percent, on average, in 2003–’07. But the index tumbled 65 percent from 1991 through 1995, after a bubble in the art market burst. The American Masters Collection I of Collectors Fund has achieved a 28.5 percent annual average return since its launch in 2007, reports Sandy Kemper, CEO of the Kansas City, Missouri–based art fund firm. Kemper, who used to head UMB Bank and is himself a collector of 20th-century American masters (many on display at Kansas City’s Kemper Museum of Contemporary Art), acknowledges the need to establish better standards for transparency, fees and valuations in the art fund sector. “We can develop more demand for the product,” he maintains, “if we establish standard methods for appraisal.”

In any case, demand among professional investors is bound to grow, he believes. As Kemper points out, “People today are worried about currency and stores of value, and art has been a fantastic store of value for millennia.” What’s more, Collectors Fund, like a few of its rivals, lets clients take home and admire their investments for short periods.