Institutional Investor

Fine Art Prices Continue to Set Records, Luring Investors

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CONVERSATIONS IN A DOZEN LANGUAGES generate a babble of excitement at Sotheby's salesroom on Manhattan's Upper East Side, where tieless, tanned American and European collectors rub shoulders with buttoned-down Chinese and Japanese rivals — all of them millionaires many times over — at the auction house's May 2 sale of impressionist and modern art. Anticipation builds as some notable Picassos and Matisses go under the hammer. Then chief auctioneer Tobias Meyer announces with a dramatic flourish, “And now for the major moment!” All eyes focus on the revolving panel on center stage, where The Scream, a masterpiece by Norwegian expressionist Edvard Munch, suddenly appears. The 1895 pastel on board, one of four renderings of Munch's iconic image of modern anxiety, is expected to break all records for an artwork sold at auction.

The bidding begins at $40 million and quickly escalates as Meyer, like a maestro bringing a symphony to a crescendo, gestures with his arms to bidders left and right: 42, 43, 46, 48. Somewhere north of $60 million, the bidding shifts outside the 600-seat room to the truly big spenders, unseen at the other end of phones manned by Sotheby's vice chairman Charles Moffett and executive vice president Stephane Connery. At $80 million the pace slows. “Is that 81, Stephane?” asks Meyer. With the bidding at a lull, he pleads, “Charlie?”

With only two bidders left, another spurt of offers brings the price to $99 million. After a long pause during which one wavering bidder relays a request via Moffett, Meyer's response breaks the tension and prompts a gush of laughter: “Yes, of course, for $99 million I have all the time in the world.” From there the bidding inches higher, until at last Meyer can squeeze out nothing more and announces, “Then I shall sell it for the historic sum of $107 million.” He knocks down the gavel, and the crowd roars. Adding Sotheby's commission, the $119.9 million total paid by the anonymous winning bidder (later reported to be Leon Black, billionaire head of Apollo Global Management) is indeed a record for an artwork sold at auction.

But almost certainly, that high-water mark won't last long. The previous record was set just two years ago when Nude, Green Leaves and Bust, a 1932 oil painting by Pablo Picasso, sold for $106.5 million at a New York sale held by rival auction house Christie's. And only a week after Sotheby's sale of The Scream, Christie's set a record for a postwar and contemporary art auction, achieving a total of $388.5 million. Mark Rothko's Orange, Red, Yellow (1961) was the highlight at that sale, fetching $87 million, a record for a contemporary work.

"These prices are wild," says Richard Feigen, a New York–based collector and dealer. "I sold a better Rothko to the National Gallery in Berlin in 1967 for $22,000!"

The art world has known plenty of records and exorbitantly high prices over the years, usually during economic booms. What is unusual about today's feverish activity is that records are being broken in the midst of a global slowdown and financial market volatility. At a time of great uncertainty, investors are seeking tangible value, whether in gold, oil or art. And never before have there been so many ultrawealthy collectors, including new ones from emerging markets, to up the ante.

"What is largely driving the increase in prices is the most basic law of economics: Demand has increased dramatically," says Christie's CEO Steven Murphy. "And the objects themselves are in scarce supply. There are no more Rothkos than the ones that have already been painted."

With prices for fine art rising so dramatically — the value of works auctioned surged 10.2 percent in 2011, according to the Mei Moses All Art Index (MMAAI), while the Standard & Poor's 500 Index was flat — talk of art as an asset class is rampant among collectors and their financial advisers. Investment funds entirely devoted to art have been launched every year in the past decade. Banks are offering loans using artworks as collateral. "Clearly, the art market is headed toward more securitization," says Adriano Picinati di Torcello, a Luxembourg-based art investment analyst for Deloitte.

Prices for many coveted artworks have escalated to the point that acquiring them is beyond the resources of just one museum. "In the past five years or so, you see several museums joining together to buy important works of art to share," says Katy Siegel, an art historian at Hunter College in New York and co-author of Art Works: Money. In February the Tate in London teamed up with the Pompidou Center in Paris and the Israel Museum in Jerusalem to buy Christian Marclay's 24-hour 2010 video collage, The Clock, for an undisclosed sum. Each museum will get to exhibit the artwork for periods of time linked to the size of its investment.

Although prices today seem to go in only one direction, art is far from a risk-free investment. In 2009 the value of art at auction plunged 23.5 percent in the wake of the global financial crisis. “Nobody knew what was going to happen, so there was a temporary freeze in activity,” says Murphy.

The long-range impact of new technology remains a question mark. Until now the Internet, which has devastated the publishing and recording industries in recent years, has been largely a plus for the art market, making information and images readily available to collectors and dealers. But the auction houses worry that an art-world version of Amazon.com or iTunes could be looming just over the horizon. Because the auction houses effectively set floor prices for galleries and private dealers, any hit that Sotheby’s and Christie’s suffer could reverberate on art prices generally.

“There will be new players emerging whom we don’t yet know about,” says Murphy, who ran the Angel classical recording unit at EMI Group and then publisher Rodale before joining Christie’s in 2010. “And it won’t take six years to see the full impact of the Internet in the art world, as it did in publishing and music.”

Already, at the lower end of the art market — works priced below $1 million — buyers and sellers are using the Internet to deal directly with each other and avoid the commissions charged by auction houses and galleries. “I think the Internet will lead to greater market segmentation,” says Sergey Skaterschikov, CEO and founder of Skate’s Art Investment Review. “But the higher end will remain the playground of the ultrarich, with an irrational pursuit of exclusive assets at exorbitant prices.”

If the big auction houses are the stock markets of the art world, then the MMAAI is their S&P 500. Launched 12 years ago by Jianping Mei and Michael Moses, professors at New York University’s Leonard N. Stern School of Business, the index compares art prices with the performance of S&P’s famous benchmark. “We decided we were going to think about art as an asset and try to get the financial community interested in it,” explains Moses. To do this, the professors needed to assemble a large list of artworks that had been sold at auction more than once, thus enabling a comparison of the initial purchase price and the subsequent sale price. By now the Mei Moses list has been expanded to 30,000 artworks, some of them with purchase and sale prices dating back more than a century.

“The past ten years have been great for art versus the stock market,” says Moses. During that period art generated a compound annual return of 7.7 percent, well ahead of the 2.9 percent return of the S&P 500.

But just as consumer stocks can outperform industrials, some segments of the art market have done much better than others. Old Masters have delivered a compound annual return of only 1.6 percent a year over the past decade, while impressionist and modern works have risen by 7.7 percent a year and postwar and contemporary art by 12.6 percent. Traditional Chinese art is easily the hottest genre; prices in this segment have climbed at a compound annual rate of 17 percent over the past decade, a reflection of the dramatic rise in Chinese wealth over the period.

But anyone hoping to use the MMAAI to prove that art will always outperform share prices is likely to be disappointed. “If you look at the past 25 years, stocks totally outperformed art, and over the past 50 years the two asset classes performed about the same,” says Moses. Between 1986 and 2011 the S&P 500 notched a compound annual return of 9.3 percent, compared with 6.5 percent for art. And from 1961 to 2011, equity prices rose by 9.2 percent a year while art prices climbed at an 8.8 percent pace.

Art investors also have to factor in transaction costs, which can be as high as 25 percent for a buyer at auction. “That’s the biggest negative for art, and the only way to justify it is to hold on to the artwork for as long a period as possible — say, at least ten to 20 years — to amortize some of those transaction costs,” says Moses. (Valuable pieces of art also incur elevated insurance and security costs.)

Transaction costs were even higher before 2000, when criminal proceedings ended seven years of collusion between Sotheby’s and Christie’s to fix commissions and prices. The two houses have dominated the fine-arts auction world for more than two centuries. Sotheby’s, founded in London in 1744, is a listed company headquartered in New York, while Christie’s, based in London since its opening in 1766, is a private company owned by French retailing and fashion magnate François Pinault, who is himself an avid collector.

In 2001 both houses agreed to equally share a civil settlement of $512 million to reimburse clients victimized by the price-fixing. Sotheby’s chairman and majority owner A. Alfred Taubman served a ten-month prison sentence and paid a $7.5 million fine, while Sotheby’s CEO Diana Brooks was sentenced to three months’ home confinement and paid a $350,000 fine. Christie’s former CEO

Christopher Davidge cooperated with the Federal Bureau of Investigation and New York prosecutors, and was granted immunity.

Even masterpieces that sell at spectacular prices today haven't necessarily outperformed the stocks of blue-chip companies. Consider, for example, the $120 million sales price for The Scream. Nobody knows what the original purchase price of that pastel version was back in 1895. But if somebody had visited Claude Monet's studio that same year and bought one of his Haystacks or Rouen Cathedral paintings, the price for each work would have been about $1,000, says Moses. "If you consider Munch as important as Monet — meaning The Scream probably also sold for about $1,000 that same year — then the return has compounded annually at about 10 percent," he says. Of course, most of the return accrued only during the past two decades, when art prices began soaring.

GOING, GOING . . . UP!

A brief history of rising values (from left): In 1987, Japanese businessman Yasuo Goto buys Vincent van Gogh's Vase with Fifteen Sunflowers *(1888) at a Christie's London auction for $39.7 million; three years later Japan's Ryoei Saito buys van Gogh's* Portrait of Dr. Gachet *(1890) at a Christie's New York auction for $82.5 million; Gustav Klimt's* Portrait of Adele Bloch-Bauer I *(1907) fetches $135 million in a private sale to New York businessman Ronald Lauder, arranged by Christie's in 2006; Paul Cézanne's* The Card Players *(1892–'93) is reported to sell for $250 million to Sheikh Saud bin-Mohammed bin-Ali al-Thani, head of Qatar's royal family, in 2011.*

Rocketing art values have attracted the interest of major banks. Institutions including Banco Santander, Citigroup and JPMorgan Chase & Co. bring in art experts to help advise their private banking clients, and offer loans to customers using art as collateral. At a November 2010 seminar for wealth managers, Deutsche Bank's head of lending and credit solutions, Michael Darriba, said the bank had extended $400 million in loans secured by art. The bank's minimum loan size is €10 million ($12.5 million); it charges interest rates of between 2 and 5 percentage points above Libor and an additional fee of 1.5 percent. "Using art as collateral is increasing because clients realize the value of their art can be enormous and are trying to monetize it and turn it into a working asset," says Deloitte's Picinati di Torcello.

Still, many wealth managers caution clients to take a careful approach to art. What bothers David Darst, chief investment strategist at Morgan Stanley Smith Barney Global Wealth Management, is that art falls into the “store of value” asset category rather than offering the steady dividends or interest rate returns of capital markets instruments. “I have a client whose 20-year-old company is now worth $600 million,” says Darst. “He also owns an art collection that he has had at least as long and is now worth over $1 billion — but where’s the income stream?”

Darst cites the sale of Vincent van Gogh’s Irises (1889) by the Whitney Payson family. Joan Whitney Payson bought the painting in 1947 for $80,000; her son, John Whitney Payson, sold it in 1987 at Sotheby’s for $53.9 million. The compound annual rate of return works out to 17.7 percent, which is considerably better than the stock market’s performance over those four decades. “But are you willing to hold on to an artwork for 40 years?” asks Darst. “And are you aware that 80 percent of the total gain occurred only in the last ten of those years?” That’s why Darst advises high-net-worth clients with financial assets of $1 million to $30 million to allocate no more than 5 percent of their portfolios to art.

As far as the truly wealthy — those with assets in the billions — it’s not clear that they follow such advice, but even Darst’s ceiling would give them considerable firepower.

According to Brett Gorvy, Christie’s chairman of contemporary art worldwide, there are three distinct markets for big-ticket artworks. A piece that sells for $10 million to $20 million has a potential pool of as many as 500 buyers, he estimates. Bump the price range up to $20 million to $40 million, and the number of bidders falls by half. “Above $40 million you are in the hands of only ten to 15 people at any one sale,” Gorvy says.

To give a sense of how rarefied the top echelon can be, Gorvy estimates that most of the fine-art revenue at Sotheby’s and Christie’s auctions is generated by a small group of some 40 extremely wealthy individuals. Most current lists of the world’s top collectors include Black and fellow U.S. investors Steven Cohen and Eli Broad, French business rivals Bernard Arnault and Pinault, and Sheikh Saud bin-Muhammed bin-Ali al-Thani, head of Qatar’s royal family.

The auction houses carefully track their regular bidders. The chief auctioneers — Sotheby’s Meyer and Christie’s Christopher Burge — keep confidential books. Each page is devoted to a painting or sculpture for sale at an auction and a seating chart showing the likely buyers for each work — the probable high bidders as well as those looking for bargains. Annotated separately on each page are the names of the phone bidders or their representatives. In many cases the page will also indicate the guarantee price that the auction house has committed to achieving for the seller whether or not there is a buyer.

Well before an auction the houses engage in elaborate strategies to stimulate interest. One favored tactic: Time a sale to follow closely on the heels of a major museum exhibition or gallery showing of the artist. Christie's did just that last year with German abstract artist Gerhard Richter. The house organized an auction in London in October 2011, just one week after a retrospective of Richter's works opened at Tate Modern. The result? One of Richter's Kerze (Candle) series, a 1982 painting, sold for $16.6 million, a record for the artist.

That strategy doesn't always work, though. A retrospective of works by Dutch-American abstract expressionist painter Willem de Kooning that ran from September 2011 to January 2012 at the Museum of Modern Art in New York drew rave reviews. But at a

May 9 auction at Phillips de Pury & Co. in New York, there were only two bidders for de Kooning's Untitled VI (1975), an abstract landscape that had been expected to sell as high as $15 million. It fetched just $11 million, with fees raising the final price to $12.4 million. "What happened is that people saw the show and expected the same museum-quality works to be up for sale at the auctions and were then disappointed," says Gorvy.

Another increasingly important consideration for auction house strategists is the role of new, superwealthy emerging-markets players in the art world, especially from Russia and China.

There are about 20 important Russian collectors; for the most part, they are oligarchs who made huge fortunes during the privatization of state assets after the fall of the Soviet Union. The art scene in Russia is much less developed than in Western countries, with very few galleries of any consequence in Moscow or St. Petersburg and no important art fairs. Serious Russian collectors do their buying abroad, and their focus is on historically recognized or well-established contemporary artists. "There is a very clear pattern of how art is bought by Russian collectors," says Skate's Art Investment Review's Skaterschikov, a Moscow-based consultant to Russian collectors. "They want to be seen as being interested in culture but also as not making mistakes, so they are not trendsetting collectors."

Only a few of these collectors keep their artworks in Russia — mainly art associated with the country's cultural history. Oil, banking and telecommunications tycoon Mikhail Fridman has an important collection of early-20th-century Russian suprematists and displays some of their paintings in his Moscow headquarters. His Alfa-Bank sponsored a foreign tour in 2003, including an exhibition at the Solomon R. Guggenheim Museum in New York, of paintings by Kazimir Malevich, the most renowned suprematist. Fridman's business partner Viktor Vekselberg has spent more than $100 million to assemble the largest collection of jeweled Fabergé eggs, made for Russia's czars. Vekselberg has repatriated his Fabergé eggs and occasionally puts them on public display, but most Russians with important collections keep them safely abroad in Geneva, London, Paris or New York.

Russians have established a stake in the global auction business. In 2008, Mercury Group, a luxury retailer that operates Moscow outlets for brands such as Armani, Bentley, Gucci and Rolex, paid $60 million for a controlling interest in New York– and London-based Phillips de Pury, retaining co-founder and chairman Simon de Pury to manage the firm. "Their logic in buying Phillips de Pury is very straightforward," says Skaterschikov. "This was another opportunity to build a global brand — and in art — and it enabled them to get involved with the highest society."

While ego and trophy purchases characterize the Russians, nationalism is the driving force in art collecting in China. By some estimates, Chinese buyers accounted for more than 15 percent of the money paid worldwide for fine art at auction last year. According to Sarina Tang, a leading dealer for wealthy Chinese clients and New York–based founder of Currents Art and Music, a nonprofit that arranges cultural interchanges between China and other countries, there are at least two identifiable groups of collectors.

"First, there are a number of entrepreneurs who founded high-tech and Internet companies like Baidu and Weibo," says Tang, referring to the Chinese equivalents of Google and Twitter. "Most of them start with Chinese contemporary art and then branch out to Western contemporary." A second group of entrepreneurs, in more-traditional businesses like real estate and banking, began collecting Chinese classical paintings from the Qing Dynasty (1644–1912) and then moved on to 20th- and 21st-century Chinese art. "That has pushed contemporary-Chinese-art prices to amazing levels," Tang says. Single works by living artists Zhang Xiaogang and Zeng Fanzhi have sold at auction for as much as $10 million over the past four years. Still, prices for traditional artworks can be much higher: An anonymous Chinese collector paid $26.7 million for a small, pale, 900-year-old ceramic bowl from the Northern Song Dynasty (960–1127) at a Sotheby's auction in Hong Kong in April.

The problem for Sotheby's and Christie's is that the Chinese are interested in auctioning their own art. Founded only seven years ago, state-owned Beijing Poly International Auction Co. is already the world's third-largest auction house: It had $1.2 billion in sales in 2011, trailing Sotheby's ($5.8 billion) and Christie's ($5.7 billion). Another state-controlled firm, China Guardian Auctions Co., is also a growing force. "Both of them have people all over the world scouting for and marketing Chinese art, because by far the most important collections of traditional Chinese art are held by overseas Chinese," says Tang.

The impact of Beijing Poly and China Guardian on the Western auction houses has been dramatic. Sotheby's saw the take at its spring Hong Kong sale drop to $316 million in April, down 29.3 percent from a year earlier. Christie's, which holds its spring Hong Kong auction in May, saw its sales tumble 31.7 percent from a year earlier, to $352 million.

Although new players are emerging, death and divorce continue to be key drivers of the art market. Auction houses still scour the obituary pages and gossip columns of the leading newspapers in the U.S. and Europe, ready to dash off condolence letters to bereaved survivors or inquiries to lawyers handling the breakups of wealthy married collectors. Getting there first isn't necessarily an advantage for Sotheby's or Christie's. "The fiduciary responsibilities of the executors require that both auction houses be approached," says Christie's Gorvy. A house can win on its merits — its Old Masters department might be stronger than its rival's, for example. Or an auction house might offer a higher estimated price range for an artwork, along with a guaranteed minimum if there are no buyers. A good track record with a collector always helps. "This is a relationship business," says Gorvy. "If clients feel you did well for them in the past, they will return."

But sometimes great art simply falls into auctioneers' laps. A notable recent case was Paul Cézanne's The Card Player, an 1892–'96 watercolor that sold at Christie's on May 1. Depicting the artist's gardener, it was used as a study for The Card Players, five oil paintings that are among Cézanne's most famous series of works. The Card Player, virtually unknown to the art world, belonged to Heinz Eichenwald, a Dallas physician. His father, a Berliner, acquired the watercolor during the 1930s and brought it to the U.S. when he fled Nazi Germany. The work had last been exhibited publicly in 1953.

"The Eichenwalds were from a generation of collectors that loved art for its own sake," says Sharon Kim, the New York–based senior specialist on impressionist and modern art who helped bring The Card Player to auction at Christie's. "They were neither concerned nor aware of the magnitude of its current commercial value."

Eichenwald died last September, and his widow, Linda, and her lawyers and bankers contacted Christie's in January for an appraisal. Properly skeptical of a "lost" Cézanne masterpiece, Kim and her staff searched through museum exhibition catalogues on The Card Players, including the

Metropolitan Museum of Art's acclaimed display of the works last year, but they found only a black-and-white image of the watercolor study with the annotation "whereabouts unknown." Then the Christie's crew turned to a comprehensive catalogue of the artist's works by famed impressionist-art historian John Rewald. It showed the same black-and-white image of The Card Player and listed its last known owners as Mr. and Mrs. Ernst Eichenwald, parents of the late Heinz Eichenwald. Bingo! "We knew this was a direct match," says Kim.

The work had last been appraised more than 20 years ago at less than $1 million. "So when we presented the auction estimate of $15 million to $20 million, it proved to be a very salient point," Kim says. "I think Mrs. Eichenwald was pleasantly surprised." Although negotiations for a major work can take many months, The Card Player was put on sale less than five months after Linda Eichenwald first contacted Christie's; the house wanted the painting as the star attraction at its impressionist and modern auction on May 1 and had to print the show's catalogue by March 1. The Cézanne sold for $19.1 million.

Megamillion-dollar acquisitions like The Scream and The Card Player dominate the art world's attention. But almost every collector begins at a more modest level, perhaps like the New York–based owner of a dozen Old Masters etchings with whom Tim Schmelcher, senior specialist in Christie's prints department, recently met to provide an estimate for a Rembrandt etching. The 10-and-a-quarter-inch by 8-and-a-half-inch work, The Angel Appearing to the Shepherds, was printed in black and white from a copper plate etched with acid by Rembrandt in 1634.

It is one of Rembrandt's more dramatic etchings, depicting an angel surrounded by cherubs and a halo of heavenly light looking down upon a night scene of startled shepherds and their animals. Schmelcher lifts the collector's spirits by informing him that his work displays good contrast and definition. The expert likes the fact that the cherubs seem to be tumbling through the air.

Only then does Schmelcher point out the defects. The large tree in the background is too enveloped in darkness, and the tufts of forest on the distant horizon are barely visible. "What distinguishes this very good impression from a really great one is the fact that the landscape has all but disappeared," Schmelcher tells the collector. The expert consoles him by noting that only a very small number of the Angel prints have been so well conserved and protected from light as to enable the details of the landscape, with their fine gradations of black and gray, to survive over centuries. Schmelcher's estimate for the work is $23,000 to $39,000 — the upper figure slightly better than the price at which the collector purchased it a year before.

Prints like the Rembrandt can be a good entry point into the world of collecting, says Schmelcher. “Generally speaking, compared to owners of paintings, people who collect prints are probably not as interested in showing off their wealth,” he says. “It is something you do for yourself, because etchings are small and require study and time to look at them closely.” The finest examples of Old Masters etchings have grown exponentially in price. The merely good tend to rise in value by about 5 percent a year — considerably less than works by contemporary artists who are in fashion.

That’s why Schmelcher is an old-fashioned believer in the slogan popularized decades ago by the Metro-Goldwyn-Mayer film studio: Ars gratia artis, or “art for art’s sake.” He says: “If a young hedge fund manager asks me how to invest $100,000 in art, I tell him to talk to his banker. The initial impulse to become a collector should be the art, not the money.” • •

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