A Look At Investing In Art

What is a stock? We can say a share of stock is ownership interest in a company, it can be tangible, it is defined and we can come up with the intrinsic value of a share. What is Art? There is no correct answer, if you were to ask Pablo Picasso, Claude Monet or Andy Warhol you would likely get three radically different answers. It is not defined and we cannot ascertain the intrinsic value of a piece of art, only what someone is willing to pay for it. That’s just where the complications begin. In this paper, we will explore what gives art value, appropriate indices to track, costs of carry, and the integrity of the art market to analyze the integrity of art as an investment.

People purchase art for many different reasons. Some enjoy the social aspect associated with the world of fine art, while others are passionate about the history and cultural associations behind it, still others look at it as an investment. Whatever the reason behind one’s art purchases, it is important to evaluate them through a different lens relative to traditional investments as art is accompanied by a very different set of risks and rewards than traditional stocks and bonds.

If you were to have the eye of The Illinois Metropolitan Pier and Exposition Authority and purchase Kerry James Marshall’s piece “Past Times”, which depicts a family enjoying a picnic in Chicago, you would have enjoyed a 48,000% return on your investment. The Illinois Metropolitan Pier and Exposition Authority purchased the piece for $25,000 in 1997 and sold it to Sean Combs for $21.1 million in 2018. This would be the art equivalent of purchasing Amazon in 1997, which through 2018 has generated a 49,000% return.

In a similar manner to the way not all stocks have experienced returns mimicking that of Amazon, not all art pieces’ experience returns similar to a Kerry James Marshall piece. Art can decline in value, and it can decline drastically. There are art booms and busts just as there are in other markets, take for example the art market collapse in 1990 which saw a 35% decrease in sales volume. There is a plethora of young artists who may have pieces to sell at high prices, only to quickly lose relevancy as they are not featured in galleries, their style goes out of favor, or they are surpassed by other artists that are simply “hotter.” According to Artnet, 25 named artists were responsible for 44.6% of contemporary auction totals in the first half of 2017, so the term “starving artist” is apropos for many.

This yields the question; what makes a piece of art desirable? With stocks, we can say that, broadly speaking, a desirable characteristic is a company that either generates a profit already, or is at least expected to at some point in the future. With art, it is not as easy to define desirable characteristics, as conventional wisdom is often absent, as evidenced by too many auction results to name here.

Considerations to determine if a piece is desirable include the style of a piece. It often can help if a piece is in a style which the artist is known for. It can help if a piece has been in notable galleries or in prominent collections. The visual appeal of the piece can be important too, pictures depicting daylight are often more desirable than night, portraits of subjects being alive are often more desirable than art depicting death. Certain colors can be more desirable than others as well - often art being displayed is more effective at gathering a viewer’s eye when it is a brighter color. There are many exceptions as art is highly subjective, making it difficult to define characteristics that are desirable on a consistent basis.

Art Indices

Many consider art to offer attractive returns, the Mei Moses index has generated a 4.6% return on an annualized basis over the previous 15 years ending in 2016 with a correlation to the S&P 500 of -0.09. On the surface, this makes an appealing case for art as an asset class to diversify a traditional stock/bond portfolio; however, it is important to understand the information that is being portrayed. The Mei Moses index has some potential biases that an investor should consider. A few examples of these biases include:
• **Repeat Sales Index:** The index only tracks pieces that are sold at auction, and have sold more than one time. The reason for this is because auction prices are public, and is a trustworthy and transparent way to construct an index.

• **Selection Bias:** Only auction results are used to construct the index. The bias comes in that most art is sold through dealers, and at an increasing rate. In 2016 dealer sales accounted for 62.5% of art sales compared to 37.5% auction sales.

• **Non-investible:** It is not possible to invest passively in the index in the same manner one is able to with a traditional equity index. While the index shows a rate of return, it is difficult to achieve the same return. There are art funds that attempt to replicate broader returns, but are often exposed to idiosyncratic risks.

Some better criteria may be how many galleries are trying to obtain a piece of art from a larger dealer, or how many museum or gallery shows are being done, how varied are the locations of the shows they do. These can be considered more in touch with the realities of demand for an artist. The lack of transparency in the market makes it difficult to assess value.

It is difficult to accurately assess the art market because many of the dealers are not transparent in their actions. Many dealer trades go unreported, which makes it difficult to construct an index which accurately reflects the market. Dealers are often one-person operations, operating with no employees. The fact that the majority of art pieces are sold in this way means the art market does not offer the same price transparency as traditional investments.

Another difference from traditional investments is liquidity. There is not a liquid market for many pieces. This can be especially true for sculptures, or paintings that are untraditional. In order for a transaction to take place there must be a buyer willing to pay a specific price for a specific piece at a specific time. If you have a piece that has a niche market, it can take an extended period of time to find a suitable buyer.

**Art Costs of Carry**

Art has a cost of carry associated with its ownership. Many stocks pay a dividend, which rewards the investor for holding the asset. Art is similar to holding a physical commodity in the sense that there is an associated cost of carry.

If you invest $10 million in a painting it would be advisable for you to also insure it. Some homeowner’s insurance policies cover art to an extent but some do not. An insurance policy would cost you approximately $1-$2 per $1000 of annual coverage, meaning that your $10,000,000 piece of art would cost you approximately $100,000-$200,000 annually to insure it. This can make holding a piece of art for many years expensive, with lower potential returns.

If you are a serious collector you may not have enough space in your home to display your art, you may need to store it, which also has an associated cost. Storing fine art often requires air conditioned, climate controlled space. Storage at these facilities often run at a premium. There are specialty storage spaces called Freeport’s, which offer high-end security and no sales taxes assessed in transactions taking place at the Freeport. There are a limited number of Freeports located in major international hubs.

**Market Integrity**

Regulation and transparency offer a reasonable assurance that traditional market participants have symmetric information available to them. This is not necessarily the case in the art market which is more susceptible to manipulation. One example of manipulation would be a dealer and co-conspirator paying a young artist $100,000 to paint ten pieces at their studio in New York. They then take the art to auction and the co-conspirator bids up the work to $110,000, setting a new price. Over time the dealer and co-conspirator sell off the remaining nine pieces close to the new inflated price.

Dealers and auction houses can also work together to ensure that prices do not drop. They can do this by bidding on works themselves or, by offering auction guarantees, which is a guarantee that the auction house or third party ensures a lot will sell for a minimum specific amount.
Counterfeiting art is a lucrative endeavor. It is a threat to the integrity of the market and the integrity of a piece. According to FAEI’s chief Yann Walther, it is estimated that 50% of artwork is forged or misattributed. This creates risk that the painting which an investor has acquired, loses nearly all of its value. It is not just individuals starting their collections who can be exposed to this risk. At Etienne Terrus, a museum in France, it was discovered that 86 of the 120 works in the museum were counterfeited.

Conclusion

Art collecting can be a fulfilling endeavor. It can help define our values as a culture and move our society forward. It can be a great way to connect individuals and evoke meaningful discussions. Art should be purchased for the love of art. It is important to consider the asymmetry of information in the art market, the illiquidity, costs of carry and sales cycle before considering it as a potential investment.

2 Factset
5 SOTHEBY’S INVESTOR BRIEFING. (2018, March).
© Regions Bank, Member FDIC. This publication has been prepared by the staff Regions Asset Management for distribution to, among others, Regions Wealth Management clients. Regions Asset Management is a business group within Regions Bank that provides investment management services to customers of Regions Bank. The information and material contained herein is provided solely for general information purposes. This material is not intended to be investment advice nor is this information intended as an offer or solicitation for the purchase or sale of any security or other financial instrument. Any opinions expressed herein are given in good faith, are subject to change without notice, and are only current as of the stated date of their issue. Certain sections of this publication contain forward-looking statements that are based on the reasonable expectations, estimates, projections and assumptions of the authors, but forward-looking statements are not guarantees of future performance and involve risks and uncertainties, which are difficult to predict. Investment ideas and strategies presented may not be suitable for all investors. No responsibility or liability is assumed by Regions Bank, its parent company, its subsidiaries or its affiliates for any loss that may directly or indirectly result from use of information, commentary or opinions in this publication by you or any other person. The content and any portion of this newsletter is for personal use only and may not be reprinted, sold or redistributed without the written consent of Regions Bank. Regions, the Regions logo and other Regions marks are trademarks of Regions Bank. The names and marks of other companies or their services or products may be the trademarks of their owners and are used only to identify such companies or their services or products and not to indicate endorsement or sponsorship of Regions or its services or products.

Employees of Regions Asset Management may have positions in securities or their derivatives that may be mentioned in this report or in their personal accounts. Additionally, affiliated companies may hold positions in the mentioned companies in their portfolios or strategies. The companies mentioned specifically are sample companies, noted for illustrative purposes only. The mention of the companies should not be construed as a recommendation to buy, hold or sell positions in your investment portfolio. Neither Regions Bank nor Regions Asset Management (collectively, “Regions”) are registered municipal advisors nor provide advice to municipal entities or obligated persons with respect to municipal financial products or the issuance of municipal securities (including regarding the structure, timing, terms and similar matters concerning municipal financial products or municipal securities issuances) or engage in the solicitation of municipal entities or obligated persons for such services. With respect to this presentation and any other information, materials or communications provided by Regions, (a) Regions is not recommending an action to any municipal entity or obligated person, (b) Regions is not acting as an advisor to any municipal entity or obligated person and does not owe a fiduciary duty pursuant to Section 15B of the Securities Exchange Act of 1934 to any municipal entity or obligated person with respect to such presentation, information, materials or communications, (c) Regions is acting for its own interests, and (d) you should discuss this presentation and any such other information, materials or communications with any and all internal and external advisors and experts that you deem appropriate before acting on this presentation or any such other information, materials or communications.

<table>
<thead>
<tr>
<th>Investment, Insurance and Annuity Products</th>
</tr>
</thead>
<tbody>
<tr>
<td>Are Not FDIC-Insured</td>
</tr>
<tr>
<td>Are Not Insured by Any Federal Government Agency</td>
</tr>
</tbody>
</table>