A FLIGHT TO QUALITY AND BEYOND

The signal being received from the art market over the past few months is one of change. The time of the unconditional and seemingly boundless boom in turnover and prices appears to be over. What is the best investment strategy to adopt in the face of hesitancy on the market?

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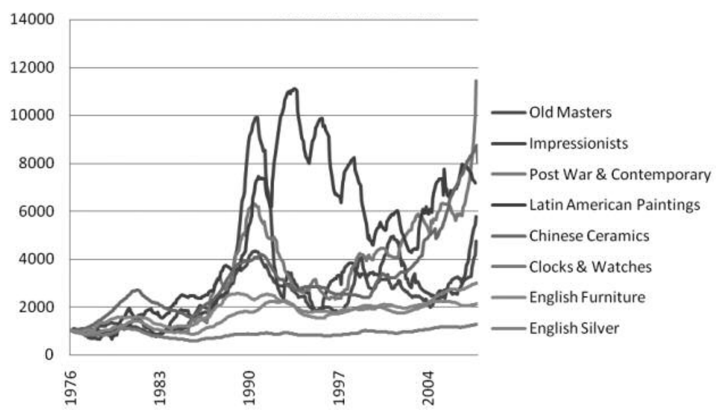
Fine & Decorative Art

(Top 10%, US$, inflation adjusted)



Source: Art Market Research

It is said that people buy contemporary art when they are confident about their economic future and society, and reminders of the past when they are not.

Judging by two post-war and contemporary art evening auctions (October 12, 2007, and February 27, 2008) at Sotheby's, London, since last year's financial crisis this vibrant part of the secondary art market, which represents about a fifth of the main auction house's turnover, appears a little weakened. If a comparison can be made between different artworks in different price ranges, in just over four months there has been a shift from buying newer art from emerging art markets to long established and expensive Western art—a flight to quality.

HIGH-FLYERS AND FAILURES

The highlights of last October's auction were the record £2.9m, paid for an artwork by the Chinese contemporary artist, Yue Minjun (*1962), for his previously unexhibited *Execution*—a third higher than the former record set by the artist in June, and the £2.7m paid for *The Garden of Earthly Delights III* by the Indian, Raqib Shaw (*1974), which sold for over four times the upper estimate, establishing a new record for that category.

By contrast, in February artists born in the West before the 1960s, including some before WWII, with a taste for the Abstract, exceeded the auction house's expectations. Leading the field were artworks by Gerhard Richter, Cy Twombly, Peter Doig, and the less familiar Malcolm Morley and Joan Mitchell. At £7m, Richter's painting was among the highest prices paid.

However, the overall picture was less encouraging. Despite an improved supply of artworks, encouraged by a 100% increase in post-war and contemporary art auction prices in just over eighteen months (see graph), the percentage of unsold lots at Sotheby's increased. In October 15% failed to sell (10 of 68 lots), with a further 6% sold below estimate, rising in February to 20% (14 of 70 lots), plus another 8% below estimate. Estimates may not be the most accurate predictor of auction prices but their role as a price anchor and the tendency to an upward price bias provides us with reliable trends. In which case, the auction houses are ill advised to continue their growing habit of not publishing estimates.

CHINESE PUZZLES

More discouraging is the downward trend in Chinese contemporary art which accounted for about 15% of the lots at both auctions. In October, 6 of the 10 artworks sold were above the higher estimate, falling last month to 4 of the 10 unsold; none exceeded estimates. Paradoxically, a similar portrait of Chairman Mao by Warhol sold better at Christie's February sale than at Sotheby's last year.

Gerhard Richter's *Struktur 1*, 1989, oil on canvas, 225 x 200 cm, was auctioned on February 27, 2008, at Sotheby's London, where it fetched £4,612,500, double its estimate.

QUO VADIS?

So, where does this leave the art investor in the short term, as some major economies flounder, and in the long run, as globalisation seems likely to distribute wealth even further?

These were some of the issues discussed by those attending an art market symposium organised by Maastricht University's Faculty of Economics & Business Administration in March 2007 and 2008 at the time of the European Art Fair (TEFAF). Economics and art have drawn ever closer since the mid 1960s when Sotheby's and *The Times* newspaper first measured sectors of the market using an index based on average prices similar to that shown.

Among the symposium's conclusions was that art shares characteristics with other financial assets, such as rare commodities, as well as luxury consumer goods. Equally, art investment's caveats were also recognised. For example, the art market tends to be a lagging economic indicator falling in price a year to eighteen months after a major stock market fall. These limitations may be reflected in over three quarters of art buyers seeing themselves as collectors rather than investors.

Art's investment drawbacks, of course, remain, but our understanding and maybe our ability to solve them has improved considerably, thanks to the increasing amount of information available and groundbreaking studies.

COMPREHENSIVE ART PRICE INDEX

At the forefront is the art price index of repeat sales in the USA since 1875 of 8,000 items of fine art (paintings, drawings, and sculptures), compiled by professors Jianping Mei and Mike Moses of NYU, now being combined with Maastricht University's study of art auctioned in Europe. Since 1952, the results have demonstrated a better return from art than bonds but less than equities. Other research has demonstrated that art has a low correlation with other assets. Including it in a diversified portfolio produces a slightly greater return with less risk than stocks and bonds on their own.

Using the Mei and Moses data it was found that art performed best relative to other investments, under conditions of above-trend inflation and growth, and worst under conditions of above-trend inflation and below-trend growth. Broadly speaking, these conditions are faced by more of today's emerging rather than developed economies.

Nevertheless, while the Mei and Moses index may provide us with an accurate picture for art resold at auction, it should be cautioned that the data includes less than 10% of the market, and ignores unsold artworks. For investors, this means excluding the fastest growing area of the art market: Those who buy at low cost from galleries, fairs, and degree shows, seeking to promote new art or artists, known as the primary art market. An approach to art buying supported by Mei and

Yue Minjun's *Execution*, 1995, oil on canvas, 150 x 300 cm, was sold on October 12, 2007 for a record sum of £2.9 million, setting a new record for the artist and a new auction high for a work of art by a contemporary Chinese artist.

Moses' striking conclusion that, in the last 125 years, the more you pay for art, especially above a certain level, the lower the return and vice versa. Today any investment potential in the primary art market may be further limited by growing international choice at art fairs, and competition to find the next best artist before cornering the market.

A more effective art investment strategy, especially during periods of economic uncertainty, may be to buy a cross section of "undervalued" fine and decorative art in the secondary market from countries with a strong cultural heritage. One strategy is defensive and the other more adventurous, mixed like other investments to maximise reward and minimise risk. In the last two decades the benefits of this type of diversification have been demonstrated by Latin American art which offered a very high rate of return and a very low correlation to international equities and other art markets such as the USA (see graph).

COUNTRY TIPS

Since art follows money, economic development is the spur to the other art investment strategy. At Maastricht University's symposium, research by Brunella Bruno and Giacomo Nocera of Bocconi University, confirms the tendency towards national art buying. Beyond today's high expectations for the economies of China, India, Russia, and Brazil, art investors may consider Goldman Sachs investment recommendation in the so called N11: Bangladesh, Egypt, Indonesia, Iran, South Korea, Mexico, Nigeria, Pakistan, Philippines, Turkey, and Vietnam. In this instance, the major art auction houses are represented in five of these countries.

Knowing exactly what to buy poses further challenges. Buyers are helped by academic studies, which show a correlation between exhibitions and art prices, and artists' internet recognition and market turnover. In 2007, it was exhibitions for Old Masters, Impressionists, Post-War and Contemporary, Antiquities and Japanese that proved the most popular worldwide. In the year ahead in the post-war and contemporary art market the same newspaper highlights exhibitions for Mark Rothko, Jeff Koons, and Peter Doig sold in the sales mentioned for prices exceeding their estimates. At Christie's, where an online auction service is offered, during their recent post-war and contemporary sale the auctioneer announced a forthcoming exhibition in Genoa which would include the Fontana. The artwork went on to sell for £6.74m, or nearly 25% above its upper estimate.

Advice that you should buy something because you like it will always be superseded by those who direct themselves to the aesthetically pleasing, the striking, the uplifting, and the unusual. For this, a knowledge of art history and art market history as well as human psychology is required. Combing these seems the likely future of art market research. ‡