New interest in art funds as market rebounds

An auction at Christies, New York. The art market has rebounded but art investment funds are difficult to run Getty Images

Specialist investing

Institutional investors still need persuading, writes **Kathryn Tully**

The rapid rebound of the global art market since 2010 has once again raised the question of whether art is something purchased out of love that can turn out to be a good investment or something that can be viewed dispassionately as an alternative asset class.

Since last year, a new batch of art investment funds, many of them from alternative asset management firms, have opened for business in a market littered by failures after the 2008 financial crisis.

There were only 12 art funds active globally last September, down from 50 in 2007, but now there are 41 different art and passion investment vehicles in different stages of development in 13 countries, according to Fine Art Wealth Management.

Plural Capital has just launched Brazilian Golden Art, Brazil's first art fund, which will specialise in Brazilian contemporary art, and, in April, Russian asset management firm Agana launched photography art fund Sobranie.Photoeffect.

"Many funds before the Lehman collapse were introduced by art world professionals that didn't necessarily have the financial acumen to structure an investment fund," says Randall Willette, founder of Fine Art Wealth Management. "Now expert fund managers are applying traditional alternative investment methodology to art, which I think will help experienced alternative investors to accept it."

That could be difficult. In the past, the majority of art funds, which often pursue a private equity-type model, failed during fundraising because they had no performance track record. Investors were sceptical that fund managers could acquire a diversified portfolio of art below market value in a market dominated by dealers and auction houses and sell it at a profit in eight to 10 years.

Fine Art Wealth Management's latest report finds that capital raising and a lack of track record remain among the key challenges facing funds, so why should the new wave of funds be any more successful than the vast majority of funds that have failed since 2008?

Mr Willette says most now recognise that transparency, experience, performance and track record are critical. "Obviously, that's difficult when these funds are so new, which is why many have brought together experts who have been successful buying and selling art with financial managers who have successfully managed alternative assets."

Investors want diversification and are worried about inflation and currency devaluation, making tangible assets popular, says Mr Willette. "Most fund managers that we're in touch with are pretty optimistic about capital raising, although that has yet to be seen in any hard and fast numbers."

Of the funds that survived the recession, some have done well. The longest running, The Fine Art Fund, established in 2001, has produced an annual internal rate of return of 25.5 per cent on sold assets. The first of its six funds, a 10-year fund specialising in western art, also called The Fine Art Fund, started distributing proceeds to investors in 2009.

The Collectors Fund, a US-based fund founded three years ago, also offers a 10-year private equity-type fund that buys American masters. The fund has already sold some works, and Sandy Kemper, its founder and chairman, says the fund has a 28.5 per cent realised net IRR.

Meanwhile, the Collection of Modern Art, an open investment fund set up by alternative asset manager Castlestone Management in 2009, has a collection of 32 art works by post-war blue-chip artists and has generated a 7.5 per cent annualised return. However, few art funds, including Castlestone's, have sold any works yet, so their numbers only indicate what they might achieve when they liquidate their collections.

In the meantime, art funds value their portfolios in a variety of ways. Some use insurance replacement value, some fair market value; others a combination of different techniques.

Fee structures also vary and, given the insurance, storage, maintenance and transaction costs associated with building an art portfolio, few have clearly articulated expense ratios or policies on early redemption costs.

The Art Fund Association, a trade body founded in New York last year, wants to bring best practice standards to the market. However, speaking at the Global Art Investment Conference in London last week, Steven Kettle, executive director of the Stonehage Group, an independent multi-family office, said if a client needed an inflation or currency hedge, he would not recommend art funds.

"Many of these benefits [attributed to art funds] can be found in other asset classes which give me daily liquidity, with more transparency and less cost."

With about $800m in global assets under management – and the biggest, The Fine Art Fund, holding $100m of that – art funds are far too small for institutional investors.

The only pension fund that has successfully invested in art was the British Rail Pension Fund in the mid-1970s, and then the institution built its own collection.

> Investing is mathematical and boring; art is subjective, passionate and speculative

Most art funds target wealthy investors and are keen to attract more, partnering with private banks, and in the case of The Fine Art Fund, offering individual managed accounts. Still, these investors do not necessarily see art purely as an investment either.

One collector of Japanese lacquer, Ancient Greek vases and contemporary English bronzes, says his motives for buying art are mixed. "Do I expect that over a long period some of my pieces will increase in value? Yes. However, I buy things because I like them and want them around me."

Mr Kettle says while he represents some families with large art collections, none hold art in their investment portfolios. "They buy art because a member of the family is passionate about it. I haven't seen an example in $30bn of family money where families are buying art as an investment."

Investing is mathematical, objective and boring, while art is subjective, passionate and relatively speculative, says Mr Kettle. He disputes the traditional assumption that art is an uncorrelated asset.

"We've seen that, as in 2008, when there are real crises, art does not perform well. We're very fortunate that art has bounced back as it has."

The private art collector believes art funds could interest some investors, but says 2 and 20 (2 per cent of assets and 20 per cent of profits), the most common fee structure, is off-putting.

"Taking 20 per cent of the profits produces an enormous incentive to create some prospect of high returns by increasing risks for the investor."

That potential for high returns, and the chance to attract new investors, make volatile markets such as contemporary art and emerging art markets popular with art investment funds.

The managers of Brazilian Golden Art, for example, argue that the Brazilian art market grew rapidly through the 2008 crisis, while other markets slumped.

However, Ana Varella, head of art advisory and development at the fund, acknowledges the risks if the current handful of blue chip Brazilian contemporary artists shoot up in price too quickly.

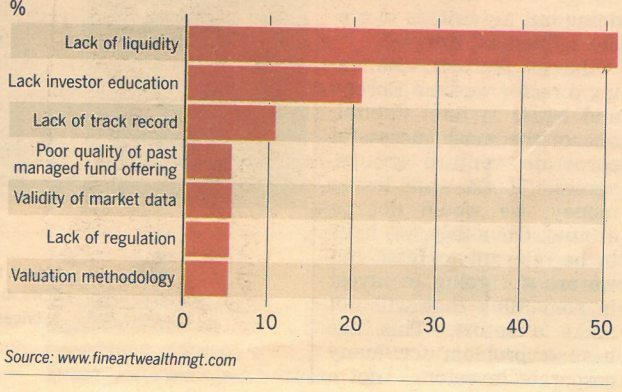
"As a fund, we have to be responsible, so that Brazilian art prices do not just skyrocket and then no one will be able to buy it."

The private collector adds that too many art funds focus on contemporary art, which he thinks is already overheated.

Mr Willette believes the market will have to evolve considerably to attract institutional investors.

But participants will have to convince more individuals that art is a viable alternative investment first.

Respondents indicating greatest obstacles to art and investments of passion becoming mainstream asset class



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